

-RESEARCH ARTICLE-

INTERNAL AUDIT QUALITY AND CORPORATE GOVERNANCE IN FRAGILE ECONOMIES: EVIDENCE FROM IRAQ

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—Abstract—

Against the backdrop of Iraq's emerging economic environment, characterized by weak institutional frameworks, feeble regulatory mechanisms, and economic and political instability, the applied value of internal audit remains an area of understudied research. This paper bridges the research on the influence of internal audit quality on company performance, earnings manipulation, and enterprise risk management in such a fragile environment. Earlier research has been conducted largely in mature economies, causing a significant knowledge discontinuity in fragile institutional settings like the ones in Iraq. For plugging the void, a quantitative research framework was adopted, involving a structured survey distributed to practitioners from non-listed firms and major listed firms, with 110 valid responses gathered in total. Structural

equation modeling (PLS-SEM) was applied to test hypothesized relationships. Findings indicate strong internal audits help firm performance considerably, reduce earnings manipulation behavior, and strengthen enterprise risk management. The study highlights poor Governance, when exposed to internal audit, inhibits organisational efficiency but also enriches financial transparency and sows greater risk resilience. Beyond financial outcomes, internal audit quality enhancement results in institutional viability through enhancing accountability, minimizing accounting manipulation, and strengthening stakeholder trust. Enhancing internal audit capability in emerging markets like Iraq is therefore critical to economic robustness and convergence with international plans of corporate governance and sustainability.

Keywords: Internal Audit Quality, Sustainability, Firm Performance, Earnings Management, Enterprise Risk Management, Developing Economy, Institutional Governance.

INTRODUCTION

Over the past decade, internal audit has undergone a profound shift, becoming the center of company governance. At the industry level, firms increasingly look to strong internal audit mechanisms to boost transparency, facilitate regulatory compliance, and drive operational efficiency. For fragile economy nations like Iraq, in which political instability, weak regulatory quality, and low integration with developed capital markets are pervasive, internal audit quality value is greater. Although the global agenda espouses the value of proper governance, there is a lack of empirical research on the internal audit quality-firm performance association, as well as internal audit quality-enterprise risk management association, and internal audit quality-earnings management association, in fragile contexts.

This evolution marks a shift from considering audit as an archaic monitoring tool to an enabling instrument capable of shaping organisational culture. Stakeholders increasingly view audit quality as an vehicle of accountability and trust, particularly in jurisdictions with poor-governing regimes. Measuring internal audit efficiency is, hence, very worthwhile to stakeholders who desire to monitor risks and retain faith. For academics, practitioners, researchers, and students are all encouraged to expand knowledge of audit performance due to an appreciation of potential contributions to deepen theoretical development and advance applied expertise. Firm performance is typically defined as an organisation's ability to generate returns, achieve strategic plans, and create shareholder wealth. This performance is typically captured through indicators like return on assets, return on equity, and growth in sales. Internal audit adds to such performance through enhancing operational efficiency, reducing waste, and supplying accurate and expedient information to management to ease strategic decisions (A. Hazaea et al., 2024). Effective audit also boosts the credibility of

publicly announced earnings, hence reducing reliance on real earnings management (Q. L. Le, 2025). The association of higher audit quality with decreased manipulation of earnings suggests audit has the potential to minimize abnormal accruals and decelerate unethical reporting misconduct (Kalembe et al., 2024). Additionally, when coupled with enterprise risk management, effective internal audit promotes healthy financial reporting, hence making the bedrock underlying sustainable firm performance improvement (S. Gao et al., 2025).

Organisational effectiveness, however prime, must not solely be tackled economically. Sustainability over the long-term, responsiveness, and sustainability of competitiveness hold equal significance. Internal audit makes its contribution towards such ends through bridging processes of operation with plans of strategy, thereby boosting short-term performance alongside sustainable sustainability. Under increasingly turbulent circumstances, alignment of audit, risk management, and profitability is all the more essential, especially for circumstances when peer review is absent or does not yield results. Iraq is a remarkable case study, considering the turbulence it has experienced incessantly ever since the year 2003, both politically and economically. Efforts have been made towards standardising audit processes, yet such programmes tended towards overlapping against investment inhibitors alongside perennial financial improprieties. Under such volatile circumstances, internal audit quality enhancement finds relevance permeating organisational ends, through to macroeconomic stability alongside governance enhancement.

Institutional fragility in Iraq conjures crucial doubts on the effectiveness of internal audits being payoffs for poorly regulated monitoring. This background also presents a compelling backdrop from which theories of governance may be tested under volatile, quantifiably riskily circumstances. For all such reasons, the value of study here lies beyond the borders of Iraq, with potential easiness of application across all such economies sharing structural fragility with all study focus. Theoretical implications of study derive from three theories. According to Agency Theory, internal audit ought to precede information asymmetry between their managers and shareholders, consequently minimizing managerial opportunism while increasing the degree of risk monitoring. According to Stakeholder Theory, internal audit ought also to portray a central role towards increasing accountability, facilitating multi-faceted needs of the stakeholders. According to Resource-Based Theory, internal audit ought similarly to become a monitor, as well as organizational strategic strength increasing the degree of organizational performance performance-wise. Individually, collectively, such theories unveil double-role nature of internal audit being tools of governance, as much as providers of organizational strategic strength. Implying such theories on the case of Iraq creates more information on the nature the degree of governance should increase under circumstances of high institutional fragility, high volatility frequency-wise. This study then strives towards adding knowledge on reviewing such interactions, as much

as creating several critical implications.

- It addresses a significant gap by presenting empirical evidence on the quality of internal audit within Iraq's fragile institutional setting.
- It explores the capacity of internal audits to limit earnings manipulation and support enterprise risk management under weak regulatory structures.
- It integrates Agency and Stakeholder Theories to advance understanding of auditing within contexts where enforcement mechanisms are limited.
- It equips regulators, policymakers, and business leaders with insights to strengthen governance systems and institutional resilience in developing economies.

Apart from these findings, the study invites subsequent research to extend, repeat the study, and conduct the study on developed and developing economies. Through extension of coverage of the coverage of theoretical and empirical work, subsequent research further guides audit quality and firm performance impact, as well as macroeconomic stability. Finally, the study sets a precedent for subsequent research and researchers who are interested in restructuring emerging markets' and who are interested in getting guidance on developing sustainable, yet credible, kinds of corporate governance structure.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Internal Audit Quality

Internal audit has come to be widely regarded as a best practice of effective corporate governance. Through independent and objective observation of risk management, internal controls, and financial reporting processes, internal audit teams play an important function in safeguarding organizational integrity. Their actions strengthen efficiency, accountability, and ethical behavior across the enterprise and protect the interests of stakeholders. Recent research has stressed the fact that audit quality is the heart of enhancing transparency, accountability, and institutional credibility since it provides an independent assessment of how effective organizations are in managing their risks, preserving control structures, and fulfilling regulatory requirements (Liu et al., 2024).

The internal audit quality is based on three fundamental attributes: independence, objectivity, and professional competence. Independence isolates the external influence from the auditors so that they execute their tasks without bias, while objectivity assures impartiality in their assessment. Professional competence—based on technical knowledge, professional conduct, and adherence to ethical standards—further solidifies the integrity of audit findings. Empirical work always vindicates independence, integrity, scepticism, and technical knowledge having overriding impact in enhancing audit quality amidst diversified institutional settings (Gunawan &

Lestari, 2025). State-of-the-art qualified audit specialists are best positioned to critique complex structures of finance, spot anomalies, and recommend critical enhancements. In a more specialized fraud investigation case, investigations reveal that knowledge blending with independence of the audit professional, accompanied with monitoring mechanisms, best augments fraud avoidance and detection efficacy (Bonrath & Eulerich, 2024).

The effectiveness of the audit process has a direct impact on the extent of assurance which financial reporting gives to interested parties. Increased degrees of independence and knowledge of technique on the part of the auditor have a correlation with share, regulator, and public confidence at a higher level. For this reason, quality audit should never be merely a feature of regulatory compliance attainment, but rather a strategic facilitator of long-term organisational robustness. This factor is particularly salient in developing economies like Iraq, in which weak governance arrangements, weak regulation enforceability, and weak internal controls remain deep-rooted problems. Here, the implementation of digital audio technologies risks creating as many problems as solutions. While they hold the promise of increasing efficiency and returning more sophisticated analytical penetration, they pose a recurring need for the enhancement of the auditor's knowledge of technique, ethical compliance, yet another risk of over-reliance on mechanisation jeopardising professional judgement, the maintenance of the value of human expertise being necessary, on a continued basis, for the maintenance of objectivity and credibility for the audit function.

In resource-constrained environments, like a majority of emerging markets, high technologies incorporation into audit work generates additional questions. These environments also create the opportunity for studying the impact on audit quality when human expertise takes the leading role of effective audit stimulator due to the lack of resources. Finally, internal audit quality creates remarkable value in robust governance, especially in-sensitive environments like the Iraq case. Maintaining independence, objectivity, and competence strengthens organisational legitimacy aside from achieving sustainable delivery and belief from the stakeholders. Although value for audit quality has been demonstrated, little attention has been given on mechanisms through which it results in noticeable findings in poor-institutional environments. Information gap filling forms the leading motivation of the current study.

Firm Performance

Organisational performance is a multi-dimensional construct reflecting a firm's capability to realise strategic intentions and generate value to organisational stakeholders. It is broadly gauged through a series of financial and non-financial indicators reflecting insight across several organisational success domains. Standard financial ratios such as return on assets (ROA), return on equity (ROE), profit

margins, and revenue growth are standard tools to assess profitability, liquidity, and overall financial viability. These assist stakeholders in determining a firm's ability to yield returns and maintain operations. Financial indicators do not, however, capture long-term success drivers adequately due to their focus on short-term results (Kokina et al., 2025).

Therefore, non-financial measures like operational effectiveness, innovation capability, customer satisfaction, employee engagement, and environmental performance are also integral to a complete perspective on organisational success. Internal audit makes a contribution towards such ends through improved processes, responsiveness to market changes, a culture of accountability, and effective management of stakeholders. A balanced scorecard approach, covering financial and non-financial measures, allows a top-down model for relating short-term operational results to longer-term strategic goals. There is constantly increasing evidence of a strong positive relationship between the effectiveness of internal audit and company performance. Internal audit creates value through improved internal controls, enhanced risk management processes, and exposure of inefficiencies cynically undermining organisational goals. Through the disclosure of irregularities in financial reporting and provision of contemporaneous corrective actions, internal audits boost profitability and stakeholders' confidence. Internal auditing also enhances accountability and transparency such that strategic planning and decision-making processes are more robust and effective. High-quality audit also reduces agency costs through an increased credibility of accounting disclosures and information asymmetry reduction (Liu et al., 2024).

In emerging markets, the internal audit value for company performance is heightened because of heightened risk due to volatility in markets, weak institutional arrangements, and deficient regulation implementation. Companies in such a context are more vulnerable to corruption, financial vagaries, and weak governance, all of which erode performance. In such vulnerable environments, internal audit becomes a viable instrument of risk management, keeping firms stable and gaining competitive advantage. However, despite its value, research-based examinations of internal audit quality organisational performance contribution in high-risk scenarios such as Iraq is non-existent. The absence of such research exemplifies the irony that just as the risk is heightened, the evidence remains poor, highlighting the research imperative in such an environment. As such, company performance is best captured with an integrated approach blending financial and non-financial indices with differential organisational viability insight. Sound internal audit provides the foundation of such balance through effective reinforcement of governance, mitigation of risks, and operationalisation of efficiency. Most of the existing evidence linking audit quality and organisational performance is from mature markets, but there is also lacking empirical verification from emerging regimes such as Iraq. This study consequently attempts to fill the

vacuum through an examination of the indirect avenues through which internal audit quality has an organisational performance influence in poor governing regimes.

Earnings Management

Earnings management refers to the deliberate alteration of financial statements with the intention of presenting a more favourable picture of a firm's performance or position than is accurate. The motivations for engaging in such practices include the need to satisfy predetermined performance targets, reduce external pressures from stakeholders, or secure performance-based compensation. Regardless of the motive, earnings management compromises the integrity of financial reporting, misleads investors, and undermines confidence in corporate governance structures (Yang et al., 2025). Persistent use of these practices poses particular risks to capital market disclosures, which rely on transparency, accountability, and credibility.

Researchers typically distinguish between two major forms of earnings management: accrual-based and real earnings management. Accrual-based manipulation refers to the use of discretion in the application of accounting principles or estimates, such as revenue recognition with delivery of goods or doubtful debts provisions. Such maneuvers help to influence reported earnings without changes in cash flows. Real earnings management occurs through changes in operating decisions or policies such as accelerating sales, reducing discretionary expenses, or slowing research and development projects. Although both practices tend to reside within admissible accounting arrangements, they tend to obscure the firm's core performance and bear great threats to long-term sustainability (Habib et al., 2022; Yang et al., 2025). One principal area of argumentation lies in the distinction of these forms: accrual-based manipulation alters reported amounts, while real manipulation changes strategic choices and thereby the long-term value of the firm.

Within this conception, the presence of a mature and independent internal audit function forms an essential defense against earnings management. Internal audit serves to raise the reliability of published accounts through observation of accounting policies, monitoring of adjustments pertaining to accruals, and assurance to stakeholders of managerial choices according to legitimate and ethical precepts. Empirical evidence confirms that firms with mature internal audit arrangements are considerably less likely to engage in opportunistic reporting (Ismael & Kamel, 2021). Through the enhancement of accountability, internal audits strengthen the credibility of published information, raise stakeholder confidence, and align managerial behaviour with appropriate principles of governance. Opposers question the proposition that the presence of an internal audit department in itself results in reduced earnings management. The value of audit depends upon the quality of operation, independence, and volume of resource invested in the audit function (Kalembe et al., 2024). If the auditors do not possess autonomy, technical expertise, or

appropriate endorsement from seniors, then the operation has the risk of becoming symbolic rather than an effective safeguard. In such situations, internal audits do not prevent managerial opportunism or generate pertinent assurance on published financial disclosures.

Studies on emerging markets have shown that the impact of internal auditing on management of earnings is greatest at those points when the regulatory supervision weakens. Without external auditing or strong accounting norms, there is a greater scope for manipulation, which allows managers to jack up reported profits, hide inefficiencies, or negotiate a better terms of financing deals. An effective internal audit could offset such threats, however, through organisational controls tightening, enhancement of timeliness and report accuracy, and promotion of ethical accountancy practices adherence. Nevertheless, despite its significance, little is understood on a relative scale on how such mechanisms function under weak governance environments, creating a notable void on internal auditing's contributing role towards constraining management of management of pay at such points (Ismael & Kamel, 2021; Kalembe et al., 2024).

The success of internal auditing in constraining earnings management hinges on a number of factors, primarily the independence of audit personnel, their technical competence, and resources invested in the function. Whereby auditors operate without management interference, they are less likely to shy away from challenging dubious practices and providing frank evaluation. Still, earnings management remains a risk to financial disclosure reliability, particularly for economies with poor governance and erratic regulatory enforcement. High-quality internal audits are thus vital towards identifying and discouraging manouvers, helping financial statement numbers better reflect organisational performance. Here, the association between audit quality and earnings management, however, remains yet under-researched for volatile or politically charged markets, for which institutional influences might fortify or undermine audit process success. Bridging this gap, therefore, is a primary motivation for the study at hand.

Enterprise Risk Management

Enterprise Risk Management (ERM) is a holistic, iterative system built for identifying, assessing, weighting, and managing risks throughout an organisation with the overarching goal of strategic goals being realised. In contrast with older risk management, which more likely focuses on narrow areas like financial, operational, or compliance risks, ERM conducts risk awareness less explicitly within organisational processes generally speaking, as well as in strategic decisions (Hidayah et al., 2024). From a holistic standpoint, organisations are not only better at recognising and averting threats but also better at perceiving and capitalising on opportunities for creating value. In response, ERM plays a central role for long-term sustainability

through increasing organisational resilience enhancement, more regulatory needs compliance, and minimising undesirable effects of unexpected disruptions on corporate goals.

Internal auditing constitutes a central mechanism for strengthening ERM, as it provides an independent and impartial evaluation of risk management systems and practices. Through systematic reviews and rigorous testing, internal auditors ensure that procedures for identifying, assessing, and mitigating risks are effective, consistently applied, and aligned with organisational priorities (Jaber et al., 2024). They also determine whether risk practices adhere to recognised standards such as the COSO ERM framework or ISO 31000. However, prior scholarship has cautioned that the extent to which internal audits enhance ERM often depends on broader organisational conditions, particularly the prevailing culture and the degree of managerial willingness to implement audit recommendations, aspects that remain relatively underexplored in academic research (Jassem, 2022). Empirical studies have consistently demonstrated that robust internal audit functions contribute positively to ERM outcomes. Firms with strong audit capacities are better positioned to navigate complex risk environments, as auditors apply specialised skills and analytical techniques to evaluate both financial and non-financial risk profiles. For example, they not only examine financial exposures such as liquidity or credit risk but also monitor operational vulnerabilities, reputational threats, and compliance deficiencies. Effective audits therefore promote more efficient operations, minimise the likelihood of unexpected losses, and foster greater trust among stakeholders. Yet much of this evidence is drawn from relatively stable contexts, and little is known about how such mechanisms function in fragile and unpredictable environments such as Iraq.

The relevance of internal audit to ERM becomes especially critical in politically unsettled and economically fragile settings. Organisations in Iraq operate amidst a context of regulatory confusion, corruption, insecurity, and macroeconomic instability. These conditions precipitate novel forms of risk exposure with the capability to undermine both operational integrity and institutional viability. Whilst theoretical discussions accept the imperativeness of effective ERM in such a setting, there is a scarcity of empirical research with reference to the extent to which internal audit buttresses effective ERM practices amongst fragile states characterised by poor governance and political turbulence. This lack of research from a contextual focus allows an added dimension of significance to an exploration of the audit-ERM interface in Iraq, a setting wherein institutional imperfections posed the potential to disrupt or undermine expected interrelationships. In short, ERM forms an organisational resilience keystone, enabling firms to accommodate risks in tandem with their strategic agenda. Internal audit, practiced effectively, buttresses ERM through the delivery of independent assurance, improved risk controls, and an organisational culture conducive to risk awareness. There does, however, exist an apparent lack of evidence with reference to the operation of such linkages in resource-

poor and politically fragile economies like Iraq. Filling such a void forms the rationale supporting the present study, an investigation whose intent is to interrogate the internal audit contribution to improved ERM in an environment of fragility.

Hypothesis Development

Agency Theory posits conflicts of interest arise between principals (shareholders) and agents (managers) because of information asymmetry enabling managers to pursue behavior conducive to their self-interests rather than shareholder value. As a companion view, Transaction Cost Theory posits organisations incur expenses in shaping, monitoring, and policing contractual arrangements. Governance mechanisms are henceforth found to play an integral part in reducing such transaction costs, but empirical evidence on the latter currently is meagre from the present era. An effective internal audit system addresses the issues from both angles concurrently through independent internal controls, operating activity, and financial reporting structure checks. Through periodic tests and intense questioning, internal audit specialists are capable of unveiling inefficiencies and shortfalls in controls prior to their manifestation as events destructive of value. This dual role makes governance more effective through managerial opportunism checks while reducing the monitoring expenses inherent with contractual arrangements, thus more efficient resource allocation.

Recent studies underscore that internal audit independence, with accompanying support from the senior management team, is imperative in securing financial performances in emerging markets (Shaban & Barakat, 2023). As much as current research from developed economies provides robust empirical support of a robust audit quality-firm performance relationship, there is an enormous void of empirical investigations from fragile institutional settings. In countries such as Iraq—where political instability is deep rooted and institutional arrangements are weak—the value addition potential from internal auditing may be conditioned, moderated, or perhaps constrained through contextual determinants. This relationship, in the Iraqi setting, provides interesting avenues of knowledge with reference to the way audit quality signals organisational performances improved amidst institutional frailty.

H1: *The quality of internal audit positively affects firm performance in companies operating in Iraq.*

Agency Theory holds that whenever there is a superior level of information possessed by managers compared to shareholders or other stakeholders, there is the potential for undue benefit through manipulation of earnings by the managers. Such behavior has purposes such as forming compensation arrangements or maintaining favorable analyst images, but ends up eroding financial statement reliability and shareholder trust (Ege et al., 2022). Left without proper incentives or constraints, managers become more oriented towards personal gains, and as such, reduce corporate

transparency and imperil long-term firm value. Stakeholder Theory generalizes the above view with the argument that firms have a responsibility towards all stakeholders such as creditors, regulators, and workers, who need transparent and credible financial reporting with which to base their decisions. Internal audit, within such a framework, assumes a prime governance role through the safeguarding of stakeholder interests through enhanced integrity and reliability in financial reporting.

An effective internal audit function strengthens control mechanisms and enhances the dependability of reported earnings. By employing structured audit planning, comprehensive testing, and consistent monitoring, auditors limit managerial capacity to manipulate results through accruals-based approaches or real activities management. This continuous oversight bolsters investor confidence and acts as a deterrent to opportunistic behaviour that could otherwise erode firm performance, even in environments where earnings management opportunities exist. Although several studies have confirmed the effectiveness of internal auditing, much of the existing evidence is drawn from developed economies characterised by robust external monitoring. Far less is known about the extent to which internal audit mechanisms achieve comparable outcomes in fragile contexts such as Iraq, where incentives and opportunities for accounting irregularities are prevalent. This lack of empirical evidence underscores the need for context-specific analysis, making it essential to examine the role of audit quality in emerging economies with weak governance infrastructures.

H2: *The quality of internal audit negatively affects earnings management in companies operating in Iraq.*

Agency Theory posits that managers, motivated by short-term performance incentives, may overlook or deliberately downplay long-term risks that are not immediately reflected in their evaluations. Institutional Theory complements this view by proposing that organisations adapt their processes and structures in response to regulatory, normative, and cognitive pressures within their institutional settings. Within this context, ERM frameworks serve as a structured mechanism to address such pressures, offering systematic procedures for identifying, evaluating, and mitigating risks across strategic, operational, financial, and compliance domains. Robust internal audit functions strengthen ERM by independently reviewing governance arrangements, verifying the adequacy of risk assessment tools, and suggesting improvements to internal control practices. Furthermore, internal auditors act as critical intermediaries between boards, executive management, and operational divisions, ensuring that risk exposures are clearly communicated and that mitigation strategies are consistent with the organisation's long-term objectives (Dellai, 2024).

Although substantial literature recognises the role of internal auditing in advancing ERM, recent studies indicate that audit effectiveness, auditor independence, and

professional competence are decisive factors in successful ERM adoption within emerging markets (Alqudah et al., 2023). However, considerably less is understood about whether internal audit quality can achieve similar effectiveness in fragile environments such as Iraq, where political instability, regulatory uncertainty, and economic sanctions create distinctive obstacles. This limitation underscores the need to investigate the audit–ERM relationship in volatile governance contexts.

H3: *The quality of internal audit positively affects enterprise risk management in companies operating in Iraq.*

Research Gap and Study Contribution

While extensive research from developed economies has established the relevance of internal audit quality, firm performance, earnings management, and enterprise risk management, significant knowledge gaps persist in underdeveloped contexts, particularly in Iraq. Although prior studies consistently confirm that internal audit plays a crucial role in strengthening governance and organisational outcomes, such evidence largely derives from environments characterised by effective regulatory enforcement, mature institutional frameworks, and stable political conditions. Conversely, the Iraqi context presents a number of challenges, since the effectiveness of internal audit is challenged by poor regulatory capability, continued political instability, and progressive development of corporate governance techniques.

Current empirical evidence supports this concern. For instance, a study on Iranian banks and Iraqi banks shows that internal audit quality perceived is highly determined by the competence and independence of the external auditors in countries such as Iraq, whose institutional supervision is volatile. Similarly, the study shows that some methodological techniques used in auditing create biasness on perceptions of audit quality (Gupta et al., 2025). Broader evidence from other emerging markets further suggests that firm-specific political risks are positively associated with both accrual-based and real earnings management, particularly in settings where regulatory enforcement and external monitoring are underdeveloped. This underscores the importance of revisiting established theoretical frameworks in contexts characterised by fragile institutional and political systems, in order to assess whether expected outcomes hold true under such circumstances.

Secondly, although prior research has examined the relationship between internal audit quality and firm performance, or its association with earnings management, these areas have typically been studied in isolation. There is still limited evidence that considers how internal audit quality simultaneously affects firm performance, earnings management, and ERM within the same institutional setting. Adopting an integrative approach is critical for capturing the full range of ways through which internal audit functions contribute to strengthening organisational resilience. A

holistic perspective is therefore essential to uncover overlapping mechanisms that explain how internal audit quality enhances organisational effectiveness. Thirdly, much of the existing literature has concentrated on descriptive observations and theoretical insights, with insufficient empirical investigation in high-risk environments. Consequently, the specific mechanisms through which internal audit quality shapes strategic, operational, and financial outcomes in developing economies remain inadequately explored. Addressing this shortfall enables evidence-based contributions that advance academic knowledge while simultaneously informing policy design and managerial decision-making in fragile markets. In response to these gaps, the current study makes several distinct contributions:

1. It provides empirical evidence on the influence of internal audit quality on firm performance, earnings management, and ERM in Iraq, a setting marked by political instability and weak institutional frameworks.
2. It integrates multiple outcomes into a unified analytical model, thereby illustrating the broader governance role of internal auditing beyond its conventional financial scope.
3. It highlights contextual factors that may shape the effectiveness of internal audits, including weak regulatory enforcement, political uncertainty, and resource limitations, offering insights relevant to firms in comparable developing economies.
4. It extends the application of Agency Theory, Transaction Cost Theory, Stakeholder Theory, and Institutional Theory to a fragile institutional context, strengthening the validity and generalisability of these governance perspectives.

By addressing these issues, the study contributes both theoretically and practically. It enriches academic understanding of audit quality in fragile contexts, while also providing actionable guidance for regulators, policymakers, and managers seeking to leverage internal audit quality to improve performance, constrain earnings management, and support ERM in challenging environments.

METHODOLOGY

This study employed a structured survey questionnaire as the primary tool for data collection and hypothesis testing. Data were gathered during the first half of 2024. The target population comprised firms listed on the Iraqi Stock Exchange, together with a set of unlisted firms selected to match listed companies in terms of size, market standing, and operational scale, thereby strengthening the representativeness of the sample (Le Vinh Quang Vietnam & Giang, 2024). Respondents were chosen according to their knowledge and experience in areas relevant to the study, namely internal audit, earnings management, firm performance, and enterprise risk management. Both paper-based and electronic questionnaires were distributed to encourage broader participation. The paper version was administered directly during

visits to company offices, while the electronic version was circulated through email and social media platforms (Le Vinh Quang Vietnam & Giang, 2024). Out of 300 distributed questionnaires, 110 valid responses were collected, yielding a response rate of 36.6% (Wu et al., 2022). Because no comprehensive sampling frame of all eligible respondents was available, a non-random sampling approach was applied. Banking and insurance firms were deliberately excluded, with the focus instead placed on companies listed on the Iraqi Stock Exchange and comparable unlisted firms operating at similar scale, with equivalent reputational and business characteristics (Wu et al., 2022). The dataset was organised using Microsoft Excel (2019 edition). Hypothesis testing and further analysis were conducted through structural equation modelling (SEM) using the partial least squares (PLS) method, implemented in SmartPLS (version 4, 2025 release) (Cheah et al., 2024).

Questionnaire Design

The research instrument consisted of 55 items divided across four main constructs:

Independent Variable – Internal Audit Quality

Measured using a scale adapted from (AL Fayi, 2022) and adjusted for the Iraqi business context. The scale included:

- One item measuring the size of the internal audit team.
- Four items assessing audit management methodology.
- Nine items evaluating the knowledge and skills of internal auditors.

Dependent Variables

1. Firm Performance: This variable was assessed through a 21-item scale developed by the researcher. The instrument captured seven dimensions, namely financial, operational, strategic, employee-related, innovation and adaptability, customer satisfaction, and sustainability/social responsibility, with each dimension represented by three items.
2. Earnings Management: Measurement of this variable was undertaken using a 10-item scale developed for the study. It comprised two sub-dimensions, accrual-based earnings management (five items) and real earnings management (five items).
3. Enterprise Risk Management: This construct was measured using a 10-item researcher-developed scale designed to assess risk management practices across different organisational domains.

All measurement items were rated on a five-point Likert scale.

Validity and Reliability

Several procedures were applied to establish the validity and reliability of the instrument:

- **Content Validity:** The items were examined by subject experts to confirm their clarity, relevance, and ability to adequately represent the constructs.
- **Construct Validity:** A pilot test was undertaken, followed by EFA, to ensure that the items appropriately reflected the underlying dimensions.
- **Reliability:** Internal consistency was measured through Cronbach's alpha coefficients, while test-retest reliability was assessed by administering the questionnaire to a small group on two separate occasions and comparing the consistency of responses.

The findings demonstrated that the questionnaire achieved both validity and reliability, confirming its suitability for evaluating internal audit quality, firm performance, earnings management, and enterprise risk management within the Iraqi context.

RESULTS

Descriptive Statistics

Table 1: Demographic Characteristics

Description	Abundance	Percentage
Gender		
Female	35	31.8
Male	75	68.2
Sum	110	100%
Age		
Under 30 Years Old	0	0
30 to 40 Years Old	17	0.15
41 to 50 Years Old	49	0.45
Over 50 Years Old	44	0.40
Sum	110	100%
Professional Experience		
Less than 10 Years	20	0.19
10 to 20 Years	41	0.36
More than 20 Years	49	0.45
Sum	110	100%
Field of Study		
Accounting and Auditing	77	0.70
Management and Economics and Finance	25	0.23
Other	8	0.07
Sum	110	100%
Education		
Bachelor's and Below	85	0.77
Master's Degree	18	0.16

PhD	7	0.06
Sum	110	100%

Table 1 summarises the findings from the demographic questions included in the questionnaire. The results show that 68.2% of the respondents were male, whereas 31.8% were female. With respect to age, 0.15% of the participants were below 40 years, and 0.36% reported having up to 20 years of professional experience. In terms of academic background, 0.70% specialised in accounting or auditing. Concerning educational attainment, 0.77% possessed a bachelor's degree or lower, 0.16% held a master's degree, and 0.06% had obtained a doctoral qualification.

Table 2 presents the descriptive statistics for the main constructs examined in this study, namely Internal Audit Quality, Company Performance, Earnings Management, and Enterprise Risk Management. The statistical indicators reported include the mean, standard deviation, skewness, and excess kurtosis. These descriptive measures provide an initial overview of the data distribution and serve as a basis for interpreting subsequent inferential analyses. Company Performance recorded the highest mean value at 0.896, accompanied by a standard deviation of 0.301, suggesting that the responses were clustered closely around the mean with limited variability. The skewness value of -0.255 indicates a marginal negative skew, while the kurtosis of -0.326 points to a distribution slightly flatter than the normal curve. Collectively, these results suggest that performance across firms is generally strong, with most firms reporting values clustered near the upper end of the scale.

In contrast, Earnings Management exhibited the lowest mean at 0.204, with a relatively higher standard deviation of 0.397. The skewness of -0.301 indicates a moderate leftward skew, and the kurtosis of 0.345 suggests heavier tails compared to a normal distribution. These values imply that, although overall earnings management is low, there is notable heterogeneity between firms, with a subset displaying more extreme engagement in earnings manipulation. Enterprise Risk Management had a mean score of 0.875 and a standard deviation of 0.328, reflecting moderate dispersion. The skewness value of -0.528 represents the strongest negative skew among the constructs, while the kurtosis of 0.117 indicates a near-normal distribution with slightly heavier tails. These results suggest that while risk management practices are widely adopted, a considerable number of firms scored below the average, thereby contributing to the skewed distribution.

Internal Audit Quality produced a mean of 0.880, reflecting consistently high quality across firms. The associated standard deviation of 0.311 indicates moderate variation. Skewness was recorded at -0.188, signifying only a slight negative skew, while the kurtosis of -0.375 denotes a flatter distribution relative to the normal curve. These findings suggest that although audit quality is generally high, some differences exist among firms, and the distribution has a lower peak than expected under normality. In

summary, all four constructs exhibit negative skewness, indicating distributions slightly concentrated towards the left. Variations in kurtosis highlight differences in peak height and tail weight, with some constructs showing distributions closer to normality while others display heavier tails or flatter profiles. These descriptive statistics provide an essential foundation for the subsequent regression analysis, ensuring that the underlying characteristics of the data are clearly understood prior to hypothesis testing.

Table 2: Descriptive Statistics for Research Constructs

Structure	Mean	Standard Deviation	Excess Kurtosis	Skewness
Internal Audit Quality	0.880	0.311	-0.375	-0.188
Company Performance	0.896	0.301	-0.235	-0.255
Earnings Management	0.204	0.397	0.345	-0.301
Enterprise Risk Management	0.875	0.328	0.117	-0.528

Evaluation of Measurement Models

To assess the measurement model, both convergent and discriminant validity were examined. Convergent validity was evaluated through indicator loadings, composite reliability (CR), and average variance extracted (AVE). As outlined by Sarstedt, Ringle, and Hair, convergent validity is confirmed when indicator loadings meet or exceed 0.40, CR and Cronbach's alpha values are above 0.70, and excessively high reliability values (above 0.95) are avoided to reduce the risk of item redundancy. In addition, AVE values should be greater than 0.50. The results of the convergent validity and reliability analysis are presented in Table 3. All constructs in the study achieved CR and Cronbach's alpha values above 0.70, along with AVE values exceeding the 0.50 threshold. These results indicate that the measurement model satisfies the established benchmarks, thereby confirming adequate convergent validity.

Table 3: Convergent Validity and Reliability Analysis of the Measurement Model

Variable Description	Average Variance Extracted (AVE)	Outlier Loadings	T-Statistic Value	Statistical Significance (P-Value)	Composite Reliability	Cronbach's Alpha
Internal Audit Quality	0.549				0.929	0.915
Methods and Procedures						
Item 1		0.665	4.944	0.000		
Item 2		0.611	5.881	0.000		
Item 3		0.686	7.489	0.000		
Item 4		0.669	5.317	0.000		

Skills						
Item 5		0.754	8.944	0.000		
Item 6		0.746	5.795	0.000		
Item 7		0.916	12.257	0.000		
Item 8		0.706	8.025	0.000		
Item 9		0.631	6.791	0.000		
Item 10		0.854	9.413	0.000		
Item 11		0.844	8.69	0.000		
Company Performance	0.583				0.909	0.888

Table 3: Convergent Validity and Reliability Analysis of the Measurement Model

Variable Description	Average Variance Extracted (AVE)	Outlier Loadings	T-Statistic Value	Statistical Significance (P-Value)	Composite Reliability	Cronbach's Alpha
Item 1		0.753	7.125	0.000		
Item 2		0.773	10.014	0.000		
Item 3		0.771	7.848	0.000		
Item 4		0.799	7.806	0.000		
Item 5		0.711	7.256	0.000		
Item 6		0.727	7.513	0.000		
Item 7		0.489	3.907	0.000		
Item 8		0.674	8.044	0.000		
Item 9		0.717	6.835	0.000		
Earnings Management	0.522				0.844	0.744
Item 1		0.734	12.958	0.000		
Item 2		0.723	10.71	0.000		
Item 3		0.729	10.473	0.000		
Item 4		0.795	12.408	0.000		
Item 5		0.619	7.676	0.000		
Enterprise Risk Management	0.577				0.845	0.756
Item 1		0.718	8.119	0.000		
Item 2		0.777	10.104	0.000		
Item 3		0.77	8.411	0.000		
Item 4		0.772	8.551	0.000		

Following the establishment of convergent validity, discriminant validity of the measurement model was established based on the Heterotrait-Monotrait (HTMT) ratio of correlations. The HTMT method assesses whether there are empirical differences for each construct, such that the constructs reflect distinctive features of the researched phenomena without overlapping with others. Table 4. shows the results of the HTMT analysis. Widely accepted criteria indicate a cut-off of 0.90 for a less stringent criterion and 0.85 for a more stringent criterion. The results indicate that all the constructs are below recommended thresholds, thus validating sufficient discriminant validity of the model (Al Fayi, 2022; Roemer et al., 2021).

Table 4: HTMT Ratio Matrix for Evaluating the Discriminant Validity of the Model

Variable	Internal Audit Quality	Company Performance	Earnings Management	Enterprise Risk Management
Internal Audit Quality				
Company Performance	0.814			
Earnings Management	0.651	0.857		
Enterprise Risk Management	0.793	0.838	0.846	

Evaluation of the Research Structural Model

Table 5 tabulates the empirical estimates of path analysis with path coefficients (β), standard error, t-statistics, and p-values of significance levels. These statistics were used for testing hypothesised relationships between internal audit quality (IAQ) and three inter-dependent constructs: corporate performance, earning management, and enterprise risk management. Based on the estimates, IAQ significantly, positively, and strongly contributes towards corporate performance ($\beta = 0.905$, $t = 19.256$, $p < 0.001$). This further suggests that companies with high-quality and effective internal audit functions experience enhanced strategic, operational, and financial performances. The high value of the t-value also lends strength towards the robustness of the finding.

With respect to earnings management, the analysis shows a significant negative association ($\beta = -0.718$, $t = 9.257$, $p < 0.001$). This suggests that an improvement in IAQ is accompanied by a reduction in both accrual-based and real earnings management practices, thereby enhancing the transparency and reliability of financial reporting. These results validate the second hypothesis and underscore the governance role of internal audit in curbing opportunistic managerial behaviour. For enterprise risk management, the findings demonstrate a positive and statistically significant relationship with IAQ ($\beta = 0.883$, $t = 19.719$, $p < 0.001$). This implies that stronger internal audit functions enhance a firm's ability to identify, evaluate, and mitigate risks, thereby strengthening resilience and supporting sustainable growth. The effect size is comparable to that observed for firm performance, which lends further support to the third hypothesis. Overall, the evidence highlights that IAQ plays a critical role in boosting firm performance, reducing earnings manipulation, and reinforcing risk management practices. The consistently large t-values and highly significant p-values ($p < 0.001$) across the tested relationships provide strong confirmation of the validity, reliability, and explanatory power of the proposed model.

Table 5: Results from Path Analysis Estimation

	Original Sample	Standard Deviation	T Statistics	P Values
AQ -> PERF	0.905	0.047	19.256	0.000
AQ -> EM	-0.718	0.078	9.257	0.000
AQ -> ERM	0.883	0.045	19.719	0.000

Table 6 reports the outcomes of the structural model estimation, incorporating the coefficient of determination (R^2), adjusted R^2 , predictive relevance (Q^2), and the variance inflation factor (VIF). The results show that internal audit quality accounts for 81.7% of the variation in firm performance ($R^2 = 0.818$; Adjusted $R^2 = 0.817$), 51.2% of the variation in earnings management ($R^2 = 0.516$; Adjusted $R^2 = 0.512$), and 77.8% of the variation in enterprise risk management ($R^2 = 0.780$; Adjusted $R^2 = 0.778$). Based on Chin's (1998) guidelines, R^2 values above 0.67 denote substantial explanatory strength, values around 0.33 reflect moderate explanatory power, and values near 0.19 are regarded as weak. In this context, the explanatory capability of the model is substantial for both enterprise risk management and firm performance, while it is moderate, though still meaningful, for earnings management.

Furthermore, all Q^2 values are positive (0.176 for firm performance, 0.155 for earnings management, and 0.163 for enterprise risk management), confirming that the endogenous constructs possess predictive relevance, thereby reinforcing the robustness of the structural model. The VIF values, which range between 1.450 and 2.428, are well below the conservative threshold of 3. This indicates that multicollinearity does not pose a problem, and each construct makes a distinct contribution to the explanatory capacity of the model. Collectively, these findings provide strong evidence that internal audit quality plays a critical role in strengthening firm performance and enhancing enterprise risk management practices (Cheung et al., 2024). At the same time, although the relationship with earnings management is statistically significant, the relatively lower explanatory power suggests that other institutional or contextual mechanisms, such as regulatory enforcement, external audit oversight, and managerial incentive structures, also contribute to constraining earnings manipulation (Bawuah, 2024; Wang & Liang, 2025).

Table 6: Results from the Structural Model Estimation

Variable Description	Variance Inflation Factor	Predictive Accuracy	Adjusted R-Squared	R-Squared
Internal Audit Quality	2.428			
Company Performance	1.958	0.176	0.817	0.818
Earnings Management	1.539	0.155	0.512	0.516
Enterprise Risk Management	1.450	0.163	0.778	0.780

Figure 1 shows the path coefficients, external loadings, and corresponding t-statistics for the constructs covered under the study. This pictorial presentation gives a complete picture of interdependencies between internal audit quality, firm performance, earnings management, and enterprise risk management, and both strength and significance of the estimated paths are reflected.

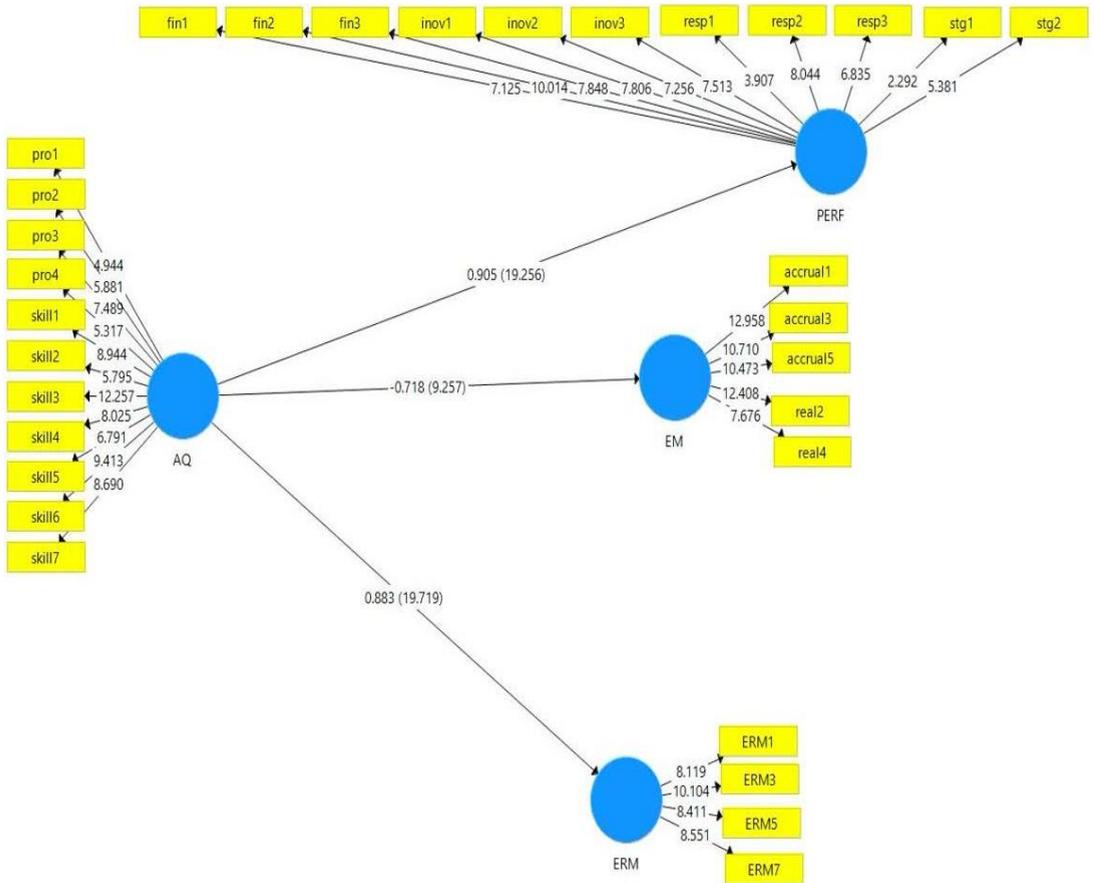


Figure 1: Values of Factor Loadings, Path Coefficients, and T-Statistics

DISCUSSION AND CONCLUSION

This research investigated the impact of internal audit quality on firm performance, earnings management, and enterprise risk management in a politically volatile and institutionally thin economy, i.e., Iraq. The results highlight the salient role of high-quality internal audits for strengthening corporate governance processes and organizational robustness. Companies showing advanced internal audit competence showed improved operational, financial, and strategic performance, validating audit effectiveness as a prime firm performance determiner overall.

From an Agency Theory perspective, effective internal audit departments reduce information asymmetry between managers and shareholders, so management decisions are more aligned with shareholder interests. This alignment helps limit opportunism, particularly earnings manipulation, through increasing the credibility and transparency of financial reporting. From a Stakeholder Theory perspective, effective internal audit reinforces accountability structures and encourages investor trust, as well as those of other stakeholder groups, emphasizing the value of

independent oversight in safeguarding varied interests. Institutional Theory also proposes that in institutional settings with weak resource provision and governing arrangements, effective internal audits can compensate institutional failures through encouraging ethical behaviour and responsible organisational actions increasing long-term viability.

The empirical evidence also demonstrates that internal audit quality positively contributes to the development of enterprise risk management capabilities. High-quality audits enhance the identification, assessment, and mitigation of strategic, operational, financial, and compliance risks. By providing independent evaluations and facilitating communication across organizational levels, internal auditors support risk-informed decision-making, improving both resilience and adaptability in volatile settings. Overall, the results suggest that even in underexplored and resource-constrained economies, internal audit quality constitutes a critical lever for improving performance, limiting earnings management, and reinforcing risk management structures. These findings not only substantiate the theoretical perspectives of Agency, Stakeholder, and Institutional theories but also provide empirical evidence supporting the centrality of internal audits in achieving organizational effectiveness under conditions of weak institutional support. Future research could further explore the role of innovation, digital technologies, and institutional transparency in enhancing audit effectiveness, thereby deepening the understanding of internal audit contributions in fragile economies.

IMPLICATIONS

The study offers several practical recommendations for stakeholders in fragile and emerging economies. Managers should view high-quality internal audits as strategic mechanisms for enhancing firm performance, reducing earnings management, and strengthening enterprise risk management. Investments in training and capacity building are essential to enable auditors to exercise independent, objective, and effective judgement. Regulators and policymakers are encouraged to establish clear criteria regarding auditor qualifications, independence, and mandates, while promoting adherence to international standards, such as COSO ERM, to standardize governance and risk management practices. Independent and internal auditors can reinforce corporate governance by conducting proactive and objective evaluations, collaborating with management and boards, and aligning audit procedures with global best practices. Independent auditors can also leverage insights from internal audits to enhance external audit quality and develop more robust governance mechanisms. Shareholders should advocate for strong internal audit functions as safeguards against earnings manipulation and managerial mismanagement. Academics and future researchers may explore the mediating and moderating influences of factors such as organisational culture, information technology, innovation, and institutional transparency, particularly in fragile economic contexts. Overall, these

recommendations underscore that enhancing internal audit quality not only improves organisational outcomes but also promotes institutional trust, accountability, and resilience, thereby supporting sustainable development goals related to robust institutions, economic growth, and responsible governance.

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