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THE EFFECT OF THE EFFECTIVENESS OF THE INTERNAL CONTROL SYSTEM OF THE ENTERPRISES ON THE VALUE ADDED OF INDEPENDENT AUDIT: DIYARBAKIR SAMPLE

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Abstract

The internal control system consists of variables that can directly or indirectly contribute to the success or failure of business activities. Auditors often evaluate the quality of the intended company's internal control system to determine and plan the scope and process of audit work. Therefore, it is important to evaluate the quality of internal control by the external auditor and to have a sufficient understanding of the entity and the internal control environment before the audit process. The aim of this study is to determine the added value perceptions of the audits carried out by the auditors of the effectiveness of the internal control systems of the enterprises. In line with this purpose, the auditors who continue their activities actively in the province of Diyarbakir constitute the universe of the research. A face-to-face survey was conducted to obtain the data of the study. Simple linear regression analyses were performed for frequency analysis and testing of hypotheses to the obtained data. As a result of the research, it is thought

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that with the efficiency of the internal control systems of the companies, the trust and transparency in the independent audit activities will increase. In addition, they think that the existence of effective internal control systems will help economic growth in enterprises and also cause activities that encourage corporate governance.

Keywords: *Internal Control, Effectiveness of Internal Control System, Independent Audit, Added Value*

1. INTRODUCTION

Businesses nowadays face intensely competitive business marketplaces and environments due to factors such as globalization, technological advances, consumer demand for variety, product innovation, and the emergence of new talented rivals. As businesses face increasingly complex, dynamic, and threatening environments, attention has shifted to the conduct of daily business relationships as well as the organization's adaptation to changing environmental conditions (Al-Sarayrah et al., 2016). Thus, the focus is on how to improve performance through increased effectiveness, efficiency, and adaptability. Ever since businesses moved beyond the control of "managers," they needed controls to regulate their operations. As private companies expanded and the number of external shareholders increased, there was a need to regulate the behavior of those who run them.

COSO (The Committee of Sponsoring Organization), which consists of five independent professional organizations in the United States, has pioneered the way in making internal control a standardized structure in enterprises. COSO internal control model is considered as a model that provides the necessary conditions (creating a control environment, risk assessment, etc.) for the regular and systematic control of the activities to be carried out in order to ensure the efficiency of the enterprise. Businesses typically utilize internal control systems to detect and manage hazards. Because of the recent increase in the number of fraud cases, developing an effective internal control system has become a key issue in corporate governance (Palermo, 2011; Lämsiluoto et.al., 2016). Adequate internal control, according to the COSO framework, guarantees that a firm is operating effectively and in line with its mission statement, that its management data and financial reporting are reliable, and that it supports compliance with relevant laws and regulations. If a corporation lacks adequate internal controls, its financial statements may reveal a significant vulnerability.

The internal control system encompasses all of the variables that can contribute to an organization's success or failure in some way, and by establishing a solid internal control system, the organization promotes efficient and effective operations that result in quality products and services that are consistent with its goals and objectives (Agbejule and Jokipii, 2009). The internal control systems method enables managers to assess how well an organization's resources are performing and how effectively it is functioning (Shannak et al., 2012). Internal control aids in the maintenance of order and uniformity in organizations. An

efficient internal control system may give managers a way to hold their programs accountable while also receiving reasonable confidence that the programs they supervise accomplish the stated goals and objectives (El-Masri et al., 2015).

The internal control system is the most important element of the sustainability of the activities of the enterprises. Due to this situation, enterprises have to make the internal control system effective and efficient. This study aims to determine the effectiveness of internal control systems in enterprises and their impact on independent audit activities. In particular, the accuracy and reliability of independent audit activities are directly related to the effectiveness of internal control systems in enterprises.

2. CONCEPTUAL FRAMEWORK

The activity focuses on outcomes (outcomes), programs or activities that are considered effective if the output achieved can meet the desired objectives. In a sense, it is defined as the result of an organization's effectiveness in achieving the desired goals or results.

Internal control can refer to a variety of things. In other words, it is impossible to provide a single ideal definition of internal control. This is due to the fact that it may be described and viewed from several angles (Cristina et al., 2010; Ngyen et al., 2018). Internal control, on the other hand, is defined as a process that is influenced by the actions of the firm's board of directors and other organizational structure levels, and it is designed to provide reasonable assurance regarding the achievement of the firm's objectives, plans, and strategies within the scope of relevant laws, rules, policies, and regulations (Domnisoru and Vînătoru, 2008; Ngyen et al., 2018). Internal control is one of numerous elements that influence an organization's performance. It is critical to attaining the stated goals of enterprises. Internal control is a need for successful operations. One of the fundamental ideas of internal control is that it only gives reasonable confidence to management that organizational objectives will be met. Because of the inherent constraints of internal control in each of the enterprises, this is the case.

Auditors often evaluate the quality of the intended company's internal control system to determine and plan the scope and process of audit work. Therefore, Generally Accepted Auditing Standards emphasize the need for an external auditor to evaluate the quality of internal control and a sufficient understanding of the entity and its internal control environment prior to the audit process. Internal control, on the other hand, contains numerous interconnected components, such as the control environment, risk assessment, control actions, communication,

and monitoring (Takahiro and Jia, 2012; Al Sawalga and Qtish, 2012; Ngyen et al., 2018).

The degree to which an internal control system interacts with it and how well it is integrated into corporate activities determines its efficiency. Internal control is a process, but its effectiveness is a condition or circumstance at the end of the process. As a result, it is vital that management and the board regularly monitor and evaluate the effectiveness of the internal control system. The operation of the system's five components determines the efficacy of an internal control system. As a result, the effectiveness of internal controls should be evaluated in relation to the internal control components. To evaluate the effectiveness of internal control, the evaluator must first understand the operations of the five components, as well as the purpose of the principles and assumptions that support the control components' operations and how they are used throughout the firm.

Internal control efficacy is critical in determining productivity development, value generation, and firm survival. The capacity of organizations to give assurance for compliance objectives, reporting objectives, business objectives, and strategic objectives is defined as the efficacy of internal control (Wang, 2015; Phornlaphatrachakorn and Kalasindhu, 2020). It can give a level and coverage of reported accounting figures that, to some extent, adhere to generally accepted accounting standards and fairly reflect the core of businesses' economic operations, assuming that relevant aims and objectives are met (Krishnan and Yu, 2012). Firms with effective internal controls can boost their operational efficiency by reducing the occurrence of incorrect financial reporting and promoting favorable legal and regulatory practices (Anh et al., 2020). As a consequence, the efficacy of internal control has a favourable impact on a company's business success. Internal control efficacy has arisen as a major issue in corporate governance. It refers to a company's ability to provide reasonable assurance regarding the effectiveness and efficiency of operations, the dependability of financial reporting, and regulatory compliance (Chang et al., 2014; Phornlaphatrachakorn and Kalasindhu, 2020). It also guarantees that organizations operate efficiently and that their management data and financial reporting are accurate in accordance with their mission statements (Länsiluoto et al., 2016).

Large corporations have recently begun to incorporate thorough management reports on the efficacy and efficiency of their internal control systems as an indicator of excellent corporate governance practice in their annual corporate reports (Saha & Arifuzzaman, 2011; Leng & Li, 2011). Internal control system evaluation, on the other hand, is largely focused on the evaluation of the intended company's internal quality control at three key levels, namely suitable internal

control, insufficient internal control, and defective internal control. The study conducted by Eskin (2021) aimed to examine the processes of a private hospital according to the components of the COSO internal control model and to evaluate the effectiveness of these procedures. As a result of the research, it was determined that the effectiveness of the processes could not be controlled because the hospital did not have an internal audit unit. It was also determined that the hospital did not have an effective internal control system. Because the efficacy of a company's internal control system is viewed as the primary determinant of audit method selection, timeliness, and the extent to which they should be applied or restricted, it is frequently regarded as a requirement for the audit process (Al Sawalga and Qtish, 2012).

According to Nusa (2020), adopting an effective Information System Audit has a favourable influence on Internal Control, which indicates that implementing an effective Information System Audit would improve the quality of Internal Control. Firms, however, may incorporate several techniques to create and strengthen their internal control systems, according to Xiao (2011). Among these include, for example, separating tasks, establishing internal audit departments, utilizing effective electronic information technologies, and placing a greater emphasis on their employees' abilities by sharing them in periodic training courses and seminars. According to Al Sawalga and Qtish (2012), in its study, found that Jordanian companies do not have the necessary experience to deal with existing internal control assessment tools. As a result of the study, some practices and recommendations were made for both the company management and external auditors.

3. METHODOLOGY OF THE RESEARCH

The research is to determine the perceptions of the auditors working actively in Diyarbakır on the effect of the effectiveness of the internal control systems of the enterprises on the added value of the independent audit. For this purpose, independent auditors working actively in Diyarbakır constitute the universe of the research.

The data were obtained as a result of applying a questionnaire to the independent auditors working actively in Diyarbakır. The questionnaire form consists of two parts. The first part consists of questions created to determine the demographic characteristics of independent auditors. In the second part, there are statements that will determine the dependent and independent variables of the research. The questionnaire form was created using the study of Gökoğlan (2019).

Considering the research purpose, four hypotheses were developed within the scope of the study. These hypotheses;

H₁: The effectiveness of the internal control system of the enterprises has a significant effect on the reliability of the financial information and reports of the enterprises.

H₂: The effectiveness of the internal control system of enterprises has a significant impact on the transparency of business activities.

H₃: The effectiveness of the internal control system of their enterprises has a significant impact on the promotion of encouragement to corporate governance.

H₄: The effectiveness of the internal control system of enterprises has a significant effect on economic growth.

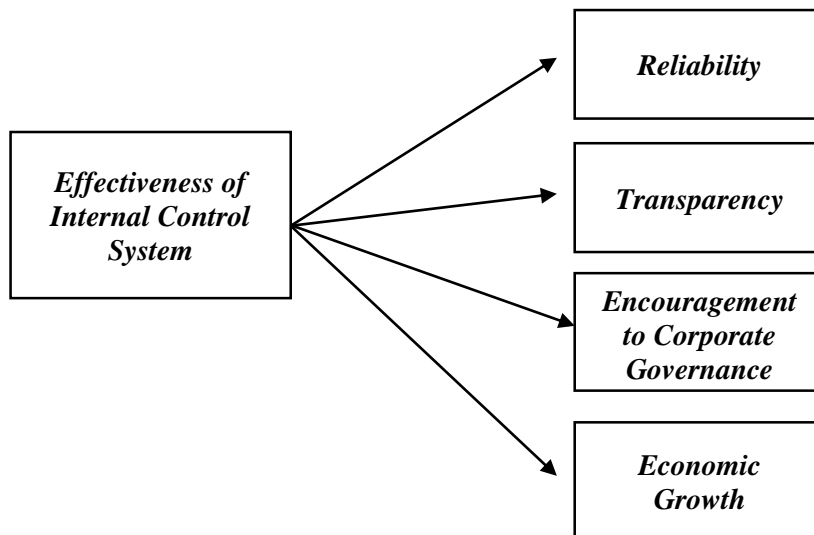
The sample of the study consists of independent auditors due to the fact that auditors are the most important personnel who can evaluate the effectiveness of the internal control systems of the enterprises and their direct impact on the added value of independent audit activities. In order to obtain the data of the research, a face-to-face questionnaire was applied to the independent auditors. A questionnaire was applied to 60 randomly selected independent auditors. Evaluations were made on 60 recycled questionnaires, and 10 questionnaires were excluded from the scope of the research due to missing or more than one marking, and 50 questionnaires were included in the research. The return rate of the questionnaires was determined as 83%. In the study, the Cronbach's alpha value was determined as (.861) to determine the reliability of the questionnaire. This rate shows that the questionnaire form has a acceptable reliability in the field of social sciences (Çiftçioğlu and Gök, 2018). According to George and Mallery (2003), $\alpha > 0.9$ (Excellent), > 0.8 (Good), > 0.7 (Acceptable), > 0.6 (Questionable), > 0.5 (Poor), and < 0.5 (Unacceptable).

Frequency analysis results of the expressions in which demographic characteristics and independent variables were formed in the study are presented in tables. Before determining the hypothesis tests in the research, normality test was applied. First of all, Kolmogorov - Smirnov test was applied whether the data in the study were distributed normally or not. As a result of the analysis, it was found that all values of the study data were lower than 0.05. This value indicates that the data is not distributed normally. Skewness and Kurtosis values were taken into consideration in order to determine the normal distribution of the data more healthily. In the evaluation, it was determined that the values of the study data were in the range of -1.5 to

+1.5. These results show that the data is distributed normally. (Tabachnick and Fidell, 2013). SPSS 22 program was used to analyze the data in the research.

In the study after the literature review, it is seen that the effectiveness of the internal control systems of the enterprises affects the audit activities. Therefore, the model of the study was created as seen in Figure 1 below.

Figure 1: Study Model



Reference: (Gökoğlan, 2019)

4. FINDINGS

The data obtained as a result of the survey applications carried out within the scope of the research were analyzed and the results were shown in tables.

4.1. Demographic Findings

73% of the independent auditors participating in the research are male and 27% are female. 10% of the participants are in the age group of 30 and below, 25% are in the age range of 31 to 40, 45% are in the age group of 41-50, and 20% are in the group of 51 and over. 52% of the participants have a bachelor's degree and 48% a master's degree. It has been determined that 5% of the participants have 3 years or less professional experience, 35% have a professional experience between 4 and 10 years, 39% have a professional experience between 11 and 20 years, and 21% have a professional experience of 21 years and above. The vast majority of the participants, 92% work with national independent auditing firms, while 8% work with one of the four major audit firms (PwC- PricewaterhouseCoopers) recognized in the world. In addition,

17% of the participants stated that they received an audit fee of less than 25,000TL, while 63% of them demanded a fee between 25,000TL and 50,000TL, and 20% more than 50,000TL.

Table 1. Frequency Values

EXPRESSIONS	<i>I do not agree</i>	<i>Neutral</i>	<i>I agree</i>	<i>Absolutely I agree</i>
Effectiveness of Internal Control System				
Timely and complete communication of the internal control deficiencies identified during the independent audit activities to the relevant parties contributes to increasing the audit quality.		%4	%60	%36
The continuity of communication between company internal auditors and independent auditors is effective in increasing the quality of independent auditing.	%2	%6	%64	%28
Independent audit activities contribute to making the financial decisions and transactions of the enterprises available to the relevant personnel.		%2	%78	%20
Independent audit activities play an important role in determining the ineffective aspects of the control environment of companies.		%10	%78	%12
Monitoring processes are of great importance in establishing an effective quality control system for independent audit activities.	%6	%6	%70	%18
Economic Growth				
Independent audit activities increase the degree of following new developments in investments and benefiting from incentives.		%22	%60	%18
The return on investment increases thanks to the audit techniques and technologies used in independent audit activities.	%6	%16	%62	%16
Independent audit activities contribute to the country's economy as well as playing a role in increasing the profit margin of the enterprises.	%8	%12	%68	%12
Independent audit activities ensure sustainable profitability.		%16	%66	%18
Independent audit activities help to provide competitive advantage among businesses.		%4	%60	%36
Encouragement to Corporate Governance				
Independent audit activities lead to activities aimed at protecting the rights and interests of company management and personnel.		%36	%46	%18
Independent audit activities increase commitment to corporate values.	%16	%8	%58	%18
Independent audit allows the establishment of strategic targets in line with the internal audit activities of enterprises.	%6	%20	%56	%18
Independent audit activities help in creating an organizational structure that can prevent conflicts of interest that may arise between the firm and the investors.		%6	%74	%20
Independent audit activities help the company management to take correct and reliable decisions.	%6	%10	%64	%20
Transparency				
During the independent audit activities, the audit team provides information about the audit process.	%4	%8	%62	%26
As a result of independent audit activities, positive or negative feedbacks are generally provided for the customer company.	%4	%8	%68	%20
During the independent audit activities, the audit team explains the	%4	%10	%68	%18

reasons for the activities performed.				
Independent audit activities allow reporting in line with the principles of transparency and accountability.	%6	%10	%66	%18
Reliability				
Independent audit activities increase the accuracy and reliability of financial reporting.		%4	%66	%30
Independent audit activities help ensure market confidence and stability.		%14	%56	%30
Performing independent audit activities in line with standards and principles increases the confidence in financial information and reporting.		%4	%64	%32
To ensure the reliability of financial reporting, auditors' reports should be independent, complete and comparable.	%4	%2	%60	%34

Table 1 shows the frequency analysis results of the answers given by the participants to the statements determined within the scope of the research. It is seen that the participants generally agreed with all the statements. In particular, it is seen that they have a positive opinion that ensuring the effectiveness of the internal control system increases the confidence in independent audit activities, encourages businesses to institutionalize, ensures the transparency of financial information and reports, and contributes to economic growth in businesses. It is also noteworthy that as seen in Table 1, no game was used to the participants' "strongly disagree" statement.

4.2. Hypothesis Tests

Simple linear regression analysis was used to measure the effect of the independent variables determined within the scope of the research on the dependent variable. The results are presented in tables.

Table 2: Hypothesis Testing (Economic Growth)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<i>(Constant)</i>	2.404	.344		6.984	.000
<i>Economic Growth</i>	.382	.079	.570	4.810	.015
R	R Square		Adjusted R Square		
.570 ^a	.325		.311		

Dependent Variable: Effectiveness of Internal Control System

Table 2 shows that there is a positive and significant relationship between the effectiveness of the internal control system and the support of independent audit activities to economic growth in enterprises ($t=6.984$, $p = 0.000 < p = 0.05$). According to the analysis

results, the fitness of the model Adjusted $R^2 = 0.311$. This suggests that the model accounts for 31.1 percent of the variance in the dependent and independent variables. Therefore, the H_1 hypothesis was accepted.

Table 3: Hypothesis Testing (Transparency)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<i>(Constant)</i>	2.233	.405		5.519	.000
<i>Transparency</i>	.438	.097	.545	4.506	.000
<i>R</i>	<i>R Square</i>		<i>Adjusted R Square</i>		
.545 ^a	.297		.283		

Dependent Variable: Effectiveness of Internal Control System

Table 3 shows that there is a positive and significant relationship between the effectiveness of the internal control system and the transparency of independent audit activities ($t=5.519$, $p = 0.000 < p = 0.05$). According to the analysis results, the fitness of the model Adjusted $R^2 = 0.283$. This suggests that the model accounts for 28.3 percent of the variance in the dependent and independent variables. Therefore, the H_2 hypothesis was accepted.

Table 4: Hypothesis Testing (Encouragement to Corporate Governance)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<i>(Constant)</i>	2.501	.361		6.926	.000
<i>Encouragement to Corporate Gov.</i>	.390	.090	.528	4.311	.000
<i>R</i>	<i>R Square</i>		<i>Adjusted R Square</i>		
.528 ^a	.279		.264		

Dependent Variable: Effectiveness of Internal Control System

Table 4 shows that there is a positive and significant relationship between the effectiveness of the internal control system and the encouragement of independent audit activities to corporate governance in enterprises ($t=6.926$, $p = 0.000 < p = 0.05$). According to the analysis results, the fitness of the model Adjusted $R^2 = 0.264$. This suggests that the model accounts for 26.4 percent of the variance in the dependent and independent variables. Therefore,

the H3 hypothesis was accepted.

Table 5: Testing Hypothesis (Reliability)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
<i>(Constant)</i>	3.014	.424		3.514	.000
<i>Reliability</i>	.526	.107	.666	8.684	.018
<i>R</i>	<i>R Square</i>	<i>Adjusted R Square</i>			
.666 ^a	.333	.184			

Dependent Variable: Effectiveness of Internal Control System

Table 5 shows that there is a positive and significant relationship between the effectiveness of the internal control system and the reliability of financial statement data and financial reporting as a result of independent audit activities ($t=3.514$, $p = 0.000 < p = 0.05$). According to the analysis results, the fitness of the model Adjusted $R^2 = 0.183$. This suggests that the model accounts for 18.3 percent of the variance in the dependent and independent variables. Therefore, the H4 hypothesis was accepted.

5. CONCLUSION

In general, it is argued that a solid internal audit system, both in terms of design and appropriateness, is beneficial to a business in risk management by allowing for the early discovery and avoidance of mistake and fraud. An efficient internal audit system ensures performance and profitability while preventing money loss. It also ensures accurate financial reporting and adherence to laws and regulations, preventing reputational harm and other consequences. Internal control systems are important strategic tools for firms seeking to improve their performance and success in today's fast-paced corporate environments. As a result, the efficacy of the internal control system is critical to the success of a corporation. In short, the fact that businesses have an effective and efficient internal control system enables them to draw a successful path in achieving their determined goals and objectives. Successful implementation of the effectiveness of internal control can affect productivity improvement, value creation and business survival.

As a result of the study, it is seen that the majority of the participants agreed with the stated statements to a large extent. In particular, they think that independent audit activities contribute to

making the financial decisions and procedures of the enterprises available to the operating personnel. In addition, it is seen that the auditors are in agreement that the effectiveness of the internal control systems plays an important role in determining the ineffective aspects of the control environment of the enterprises.

According to the results of the study, it was first determined that the effectiveness of the internal control system indirectly contributed to the economic growth of the enterprises. This contribution is often effective in making the right decisions in the activities carried out by the enterprise. In addition, it will lead to the presentation of accurate and reliable information together with independent audit activities and the image of the enterprise in the market will increase positively in this direction. This will contribute to the economic development and growth of the enterprise. A second important result is that the effectiveness of the internal control systems of enterprises will increase the accuracy of the information and data presented by the enterprise. Therefore, independent auditors who make financial reporting using these accurate data and information provided by the entity will complete the transactions transparently. Accordingly, it increases transparency in independent audit activities. In addition, the accuracy and reliability of financial reporting will be ensured as the accuracy and reliability of the financial statements to be presented by the entity will increase.

According to the auditors participating in the research, they believe that the effectiveness of internal control systems in enterprises leads to economic growth, increased transparency of audit activities, incentives to corporate governance and increases the reliability of information and financial reporting in financial statements. In particular, the operation of an effective and efficient internal control system of the enterprises helps independent audit activities to increase the value-added transactions. Therefore, it should allow both internal and external auditors to work in an organized manner in the formation of effective and efficient internal control systems of enterprises.

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