

The Corporate Governance Mechanisms and the Internal Audit Quality

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Abstract: *This study investigated the effect of corporate governance mechanisms on the internal audit quality of industrial companies listed on Amman stock exchange. It aimed to examining the relationship between a set of governance mechanisms that include board size, the proportion of independent non-executive directors, the number of audit Committee meetings, and corporate leverage ratio and internal audit quality in industrial companies listed on Amman stock exchange.*

The company's internal audit quality was measured by measuring the extent of application Internal audit standards in the company, and the researcher prepare a questionnaire, that measures the extent of application Internal audit standards in the company, where data of corporate governance mechanisms was collected from the financial year report 2015.

The study population consisted of all industrial companies listed on the Amman Stock Exchange, but the researcher used randomly sample from 20 companies from industrial companies, the researcher was distribute of the questionnaire for two internal auditors for each company, but what was subjected to statistical analysis only (29). Regression analysis was used to determine whether the existing corporate governance mechanisms influence the internal audit quality or not.

Results showed that the proportion of independent non-executive directors, the number of audit Committee meetings, and corporate leverage ratio affect on the company's internal audit quality, but the board size didn't affect on the company's internal audit quality.

Keywords: *The Corporate Governance Mechanism and The Internal Audit Quality*

1. INTRODUCTION

As a result of financial scandals that have occurred in a number of financial companies in the world, the importance of internal audit is increasing as a tool and function that helps the companies, because of its role in internal controls in the company, more ever, the internal audit is essential to find a proper internal controls system in the company.

High internal audit quality is improve the confidence of investors in financial statements and increase fundraising possibilities (Lin and Liu, 2009); moreover, many researches found that high audit quality lead to lower costs of capital (Pittman and Fortin, 2004; Hartarska, 2009; Knechel et al., 2008).

In order to improve the internal audit quality, the Institute of Internal Auditors in the United States of America (IIA) have established internal audit standards, which includes two types of standards: the attribute standards which specializes of the nature of entities and individuals who perform internal audits, and performance standards which specializes of the nature of internal audit activities, and developing a measures that can measure the performance (IIA, 2009).

High internal audit quality important for companies that need to increase funds, , several studies have found that a firms demand for high-quality audit services is related to its financing needs (Knechel et al., 2008) and its leverage (Broye and Weill, 2008). Moreover, prior studies indicate that audit quality is related to both corporate governance (Hay et al., 2006; Lin and Liu, 2009) and firm complexity (Hay et al., 2006; Knechel et al., 2008).

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which

the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined (OECD 2004). Corporate governance includes set of mechanisms that include board size, the proportion of independent non-executive directors, the number of audit Committee meetings, corporate leverage ratio.

The study aimed to investigate the effect of corporate governance mechanisms in the internal audit quality in industrial companies listed on ASE.

1.1. Research Problem

The improvement of the internal audit quality is important and vital for any company, because of its role in ensuring that the employees comply with the policies and procedures established by the high management, in addition, the improvement of the internal audit quality increases the confidence in the financial statements of the company by interested users, the corporate governance mechanisms is a modern methods that are found to deal with financial crises and scandals that have occurred recently. Based on the above, the problem of the study focused to know the effect of the corporate governance mechanisms in improving internal audit quality in industrial companies listed on ASE.

Explain the elements of the problem can be by answering the sub-questions :

1. What is the effect of board size in improving the internal audit quality in industrial companies listed on ASE?
2. What is the effect of the proportion of independent non-executive directors in improving the internal audit quality in industrial companies listed on ASE?
3. What is the effect of the number of audit committee meetings in improving the internal audit quality in industrial companies listed on ASE?
4. What is the effect of corporate leverage ratio in improving the internal audit quality in industrial companies listed on ASE?

1.2. Research Importance

The subject of corporate governance is one of the research areas in which researchers concerned with at the international level in the recent period.

The importance of this study is highlights through the analysis of the role of corporate governance mechanisms in improving the internal audit quality in industrial companies listed on the ASE, and this study will be presented to the beneficiaries in the Hashemite Kingdom of Jordan, some field results related to the impact of the application of corporate governance mechanisms in improving the quality of internal audit.

1.3. Research Objectives

This study aims to achieve a set of goals, including:

1. Measuring the effect of board size in improving the internal audit quality in industrial companies listed on ASE.
2. Measuring the effect of the proportion of independent non-executive directors in improving the internal audit quality in industrial companies listed on the ASE.
3. Measuring the effect of the number of audit committee meetings in improving internal audit quality in industrial companies listed on ASE.
4. Measuring the effect of corporate leverage ratio in improving internal audit quality in industrial companies listed on the ASE.

1.4. Previous Studies

Jamil, et al, (2016), the impact of corporate governance mechanisms on firm performance in Pakistan

The study investigated the impact of corporate governance mechanisms on the firm performance of listed firms in Karachi stock exchange, the study found that Institutional investor has significant and positive impact on firm performance. Government Ownership, Debt to Equity Ratio and Board Size

have negative and significant impact on firm performance. The remaining three variables (Firm size, CEO duality and Non Executive director) have non-significant relationship with firm performance.

Peters, George, (2014), Corporate Governance Mechanisms and Financial Performance of Listed Firms in Nigeria

The aim of this study was to examine empirically the impact of corporate governance mechanisms on firm financial performance using listed firms in Nigeria as case study for two years 2010 and 2011. The result of the study showed that most of the corporate governance items were disclosed by the case study firms. The result also showed that the banking sector has the highest level of corporate governance disclosure compared to the other two sectors. The result thus indicates that the nature of control over the sector have an impact on companies' decision to disclose online information about their corporate governance in Nigeria; and that there were no significant differences among firms with low corporate governance quotient and those with higher corporate governance in terms of their financial performance.

Beisland, Mersland and Strom, (2013), Audit Quality and Corporate Governance: Evidence from the Microfinance Industry

This study analyzed the relationships between audit quality and governance mechanisms, and it used a unique, hand-collected sample of microfinance institutions from 73 developing countries.

The study measured audit quality by the use of Big Four auditors and the presence of internal auditors.

The empirical analysis of this study reveals that these two quality metrics are highly related, although we also demonstrate that these metrics capture distinctive aspects of audit quality. In particular, the presence of internal auditors is related to other indicators of stricter governance, whereas the use of Big Four auditors is generally unrelated to other control mechanisms

Al Abdali, (2012) the Effect of Corporate Governance Implementation upon the Quality of Internal Audit

The study aims to measuring the effect of the pillars of corporate governance implementation on the quality of internal audit in the industrial companies listed in Kuwait Stock Exchange. The study's results concluded that there is an effect of the pillars corporate governance implementation (disclosure, transparency, accountability, responsibility, fairness, independence, laws and regulations) collectively and individually on the quality of internal audit in these companies

Mangena & Pike, (2005),The effect of audit committee shareholding, financial expertise and size on interim financial disclosures,

The study focused on finding the relationship between the level of corporate governance and disclosure, through empirically examining the relationship between selected audit committee characteristics and the level of disclosure in interim reports of a sample of 262 UK listed, the audit committee characteristics examined are shareholding of audit committee members, audit committee size and audit committee financial expertise.

The study found there is a significant negative association between shareholding of audit committee members and interim disclosure, the results provide evidence of a significant positive association between interim disclosure and audit committee financial expertise, and no significant relationship between audit committee size and the extent of disclosure in interim reports.

Nejem, Ban, (2013), Integrative role for Internal Audit in the Effectiveness of Corporate Governance

The study aims to identify the importance of the audit role, being a foundation to corporate governance in light of the separation between ownership and management, contributing to the examination and evaluation in internal control activities, supplying administration with the necessary information to achieve control.

The research found that there is a need to review the laws and regulations that related of Iraqi companies, to coordinate with international practices and regulations of corporate governance.

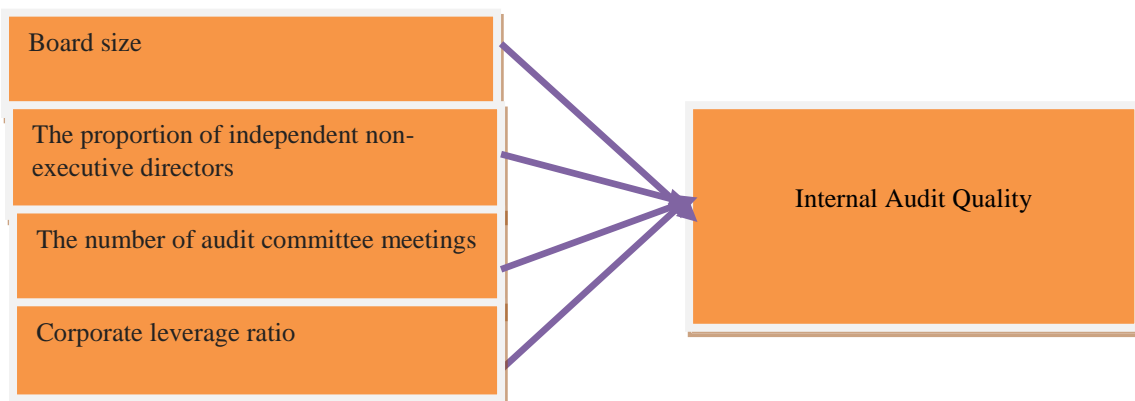
Gomaa, Ahmed, (2004), Perception of Higher Management for Knowledge Development in IAP and its Impact on the Role of Internal Auditor: Analytical, Testing Study in the Jordanian Businesses Organizations

The study aims to identifying the duties of the internal audit in the business organizations, especially after the publication of the new framework on internal audit practice issued by the IIA in America in 2003 through the internet. To achieve this objective, the researcher divided the study into sections with the theoretical section dealing with analyzing scientific contribution and professional efforts in developing knowledge in IAP. The researcher concluded that internal auditors in the 21st century are required to audit everything in the organization, and that internal audit acquired the characteristics of the “Full-Fledged profession” after it had accomplished an integrated body of knowledge structure.

2. RESEARCH MODEL & HYPOTHESES

2.1. Research Model

The model of the study is below:



2.2. Research Hypotheses

The study hypotheses were as follows:

Ho₁: There are no statistically significant relationship trends in the study sample about the effect of board size in improving the internal audit quality in industrial companies listed on ASE.

Ho₂: There are no statistically significant relationship trends in the study sample about the effect of the proportion of independent non-executive directors in improving the internal audit quality in industrial companies listed on ASE.

Ho₃: There are no statistically significant relationship trends in the study sample about the effect of the number of audit committee meetings in improving the internal audit quality in industrial companies listed on ASE.

Ho₄: There are no statistically significant relationship trends in the study sample about the effect of corporate leverage ratio in improving the internal audit quality in industrial companies listed on ASE.

3. STUDY INSTRUMENTS

After completion of the study to determine problems and hypotheses, the researcher prepared a questionnaire study, and study instrument include the following:

3.1. Data Collection

There are two sources of data collection are:

- A. Secondary sources: where they were collecting data and information from the study by reviewing the literature studies related to the study by reviewing books and articles published, in addition to use Internet.
- B. Primary sources: the study used the field survey of industrial companies listed on ASE, to learn about the effect of corporate governance mechanisms on internal audit quality of these companies.

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The study prepared a questionnaire study, which included all aspects of the study and its hypothesis. It consists of two parts:

The first part includes the demographic characteristics.

The second Part has designed to measure the independent variables.

3.2. Study Variables and how to Measure

The study variables are consist:

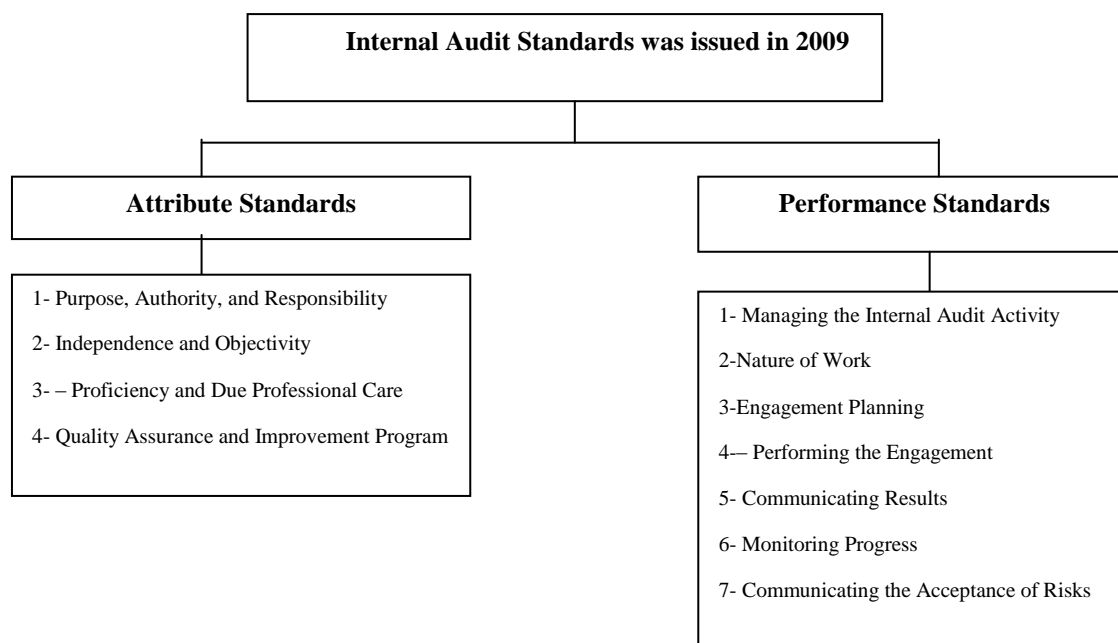
the dependent variable is internal audit quality of the company, and the independent variables are Corporate governance includes set of mechanisms that include board size, the proportion of independent non-executive directors, the number of audit Committee meetings, corporate leverage ratio, and the company's market share.

Dependent Variable: Internal Audit Quality

The company's internal audit quality was measured by measuring the extent of application internal audit standards in the company.

The research prepare a questionnaire, that measures the extent of application Internal audit standards in the company.

The Institute of Internal Auditors in the United States of America (IIA) have established internal audit standards, which includes two types of standards: the attribute standards which specializes of the nature of properties and individuals who perform internal audits, and performance standards which specializes the nature of internal audit activities, and developing a measures that can measure the performance (IIA, 2009).



Independent variables: Corporate governance includes set of mechanisms that include:

- 1- Board size.
- 2- The proportion of independent non-executive directors.
- 3- The number of audit Committee meetings.
- 4- Corporate leverage ratio.

3.3. Study Instrument Scale

Five points Likert scale has been selected, for being one of the most metrics used to measure the opinions and responses, due to its ease of understanding , indicates where the study sample under test for the extent of their agreement for each paragraph of the questionnaire as follows:

Strongly Agree	Agree	Not sure	Disagree	Strongly Disagree
5	4	3	2	1

3.4. Sampling

The study population consisted of all industrial companies listed on ASE.

The researcher used randomly sample from 20 industrial companies, and the researcher distributed of the questionnaire for two internal auditors for each company. The totaling (40) questionnaires, but what was subjected to statistical analysis only (29) because of the lack of returned or completion of the respondents, it was representing (72.5%).

To achieve the objectives of the study were used scale (Likert) as mentioned above.

The averages were determined for the purposes of the study as follows: (4.25-5) indicate a very high degree, (3.50-4.24), indicating a high degree, (2.75-3.49) indicates a medium degree, (2-2.74) indicate the degree low (less than 2) show a very low degree.

3.5. Statistical Techniques

In order to process the data that have obtained through the study field of the surveyed sample; specifically the researcher used statistical methods the following:

1. **Cronbach's Alpha Coefficient:** It used to test the reliability tool to study under which the data are collected. In other words, it used to test internal consistency of the paragraphs of the questionnaire.
2. **Frequencies and Percentages:** they used to identify the characteristics of the study sample.
3. **Mean:** it used to identify the level of severity of the answer to the sample of the study`.
4. **Standard Deviation:** it used to determine the dispersion of the study sample answers from the values of the arithmetic average.
5. **Simple Regression Test:** Simple Regression and regression analysis variance (ANOVA) to measure the impact of independent variables on the dependent variable.

3.6. Test The Validity and Reliability of the Tool

To ensure the internal consistency of the questionnaire questions and verification of constancy, the test was used (alpha (Cronbach-Alpha as the reliability coefficient calculated by this method shows the stability and consistency and rely largely.

In applying the test (alpha (Cronbach-Alpha to Questions that measure the variables of the study and the 20 questions, the alpha value was worth 0.8792, and this shows that the questions closely linked to high and that there is a high degree of stability to all the questions.

4. TEST HYPOTHESIS AND DISCUSSION THE RESULTS

The researchers using EXCEL and Statistical Package for Social Sciences program (SPSS) to analyze the data and identify the descriptive statistics of the variables. The results of the study hypothesis testing, shown in Table1 descriptive statistics for the variables of the study. Tables (2,3,4 and 5) show test of hypotheses of the study results.

Descriptive Statistics

Table1. Descriptive statistics variables of the study

	N	Minimum	Maximum	Mean	Std. Deviation
Internal Audit Quality	20	1.95	4.70	3.4845	.73292
Board Size	20	8.00	13.00	10.9000	1.68273
Prop. of Indep. Directors	20	.23	.62	.4015	.11220
Number of AC meetings	20	3.00	6.00	3.9500	1.09904
Corporate Leverage	20	.09	.88	.6697	.28526

4.1. First Hypothesis

There are no statistically significant relationship trends in the study sample about the effect of board size in improving the internal audit quality in industrial companies listed on ASE.

It tested the of the effect of board size in improving the internal audit quality in industrial companies listed on ASE, using simple regression method (Simple Regression) located in the SPSS program, has been getting the results shown in the following table:

Table2. Regression analysis of variance table (ANOVA) First hypothesis

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.054	1	.054	.096	.760 ^a
	Residual	10.152	18	.564		
	Total	10.206	19			

The table shows result of test the effect of board size in improving the internal audit quality in industrial companies listed on ASE. As the value of P-value sig results. = 0.760, which is more than the significance level $\alpha = 0.05$ value. Therefore, rejects the hypothesis of alternative and accept the nihilism hypothesis, which is:

The board size doesn't effect in improving the internal audit quality in industrial companies listed on ASE.

4.2. Second Hypothesis

There are no statistically significant relationship trends in the study sample about the effect of the proportion of independent non-executive directors in improving the internal audit quality in industrial companies listed on ASE.

It tested the effect of the proportion of independent non-executive directors in improving the internal audit quality in industrial companies listed on ASE, using simple regression method (Simple Regression) located in the SPSS program, has been getting the results shown in the following table:

Table3. Regression analysis of variance table (ANOVA) Second hypothesis

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.015	1	3.015	7.546	.013 ^a
	Residual	7.192	18	.400		
	Total	10.206	19			

The table shows result of test the proportion of independent non-executive directors in improving the internal audit quality in industrial companies listed on ASE. As the value of P-value sig results. = 0.013, which is less than the significance level $\alpha = 0.05$ value. Therefore, rejects the hypothesis of nihilism and accept the alternative hypothesis, which is;

The proportion of independent non-executive directors affect in improving the internal audit quality in industrial companies listed on ASE

4.3. Third Hypothesis

There are no statistically significant relationship trends in the study sample about the effect of the number of audit committee meetings in improving the internal audit quality in industrial companies listed on ASE.

It tested the effect of the number of audit committee meetings in improving the internal audit quality in industrial companies listed on ASE, using simple regression method (Simple Regression) located in the SPSS program, has been getting the results shown in the following table:

Table4. Regression analysis of variance table (ANOVA) Third hypothesis

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.887	1	3.887	11.070	.004 ^a
	Residual	6.320	18	.351		
	Total	10.206	19			

The table shows result of test the effect of the number of audit committee meetings in improving the internal audit quality in industrial companies listed on ASE. As the value of P-value sig results. = 0.004, which is less than the significance level $\alpha = 0.05$ value. Therefore, rejects the hypothesis of nihilism and accept the alternative hypothesis, which is; **the number of audit committee meetings affect in improving the internal audit quality in industrial companies listed on ASE.**

4.4. Fourth Hypothesis

There are no statistically significant relationship trends in the study sample about the effect of corporate leverage ratio in improving the internal audit quality in industrial companies listed on ASE.

tested the effect of corporate leverage ratio in improving the internal audit quality in industrial companies listed on ASE, using simple regression method (Simple Regression) located in the SPSS program, has been getting the results shown in the following table:

Table5. Regression analysis of variance table (ANOVA) Fourth hypothesis

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.510	1	4.510	14.249	.001 ^a
	Residual	5.697	18	.316		
	Total	10.206	19			

The table shows result of test the effect of corporate leverage ratio in improving the internal audit quality in industrial companies listed on ASE. As the value of P-value sig results. = 0.001, which is less than the significance level $\alpha = 0.05$ value. Therefore, rejects the hypothesis of nihilism and accept the alternative hypothesis, which is;

Corporate leverage ratio affect in improving the internal audit quality in industrial companies listed on ASE.

5. THE CONCLUSIONS AND RECOMMENDATIONS

5.1. The Conclusions

The researcher reach to the following conclusions:

1. The corporate governance mechanisms can give many benefits for companies. They represented by increase the internal audit quality.
2. The study show that there is no a statistically significant relationship in the field study sample between the board size and the internal audit quality of industrial companies listed on Amman stock exchange.
3. The study show that there is a statistically significant relationship in the field study sample between the proportion of independent non-executive directors and the internal audit quality of industrial companies listed on Amman stock exchange.
4. The study show that there is a statistically significant relationship in the field study sample between the number of audit committee meetings and the internal audit quality of industrial companies listed on Amman stock exchange.
5. The study show that there is a statistically significant relationship in the field study sample between the corporate leverage ratio and the internal audit quality of industrial companies listed on Amman stock exchange.

5.2. Recommendations

The researcher may suggest the following recommendations:

1. The need to encourage companies to comply with the internal audit standards in order to increase the internal audit quality.
2. The need to find regulations and legislations that obliges companies to increase the number of independent non-executive directors on the board.
3. Carry out further studies related to the corporate governance mechanisms and the quality of internal audit.

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