



## THE IMPACT OF INTERNAL CONTROL SYSTEMS ON THE QUALITY OF FINANCIAL REPORTS

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### Abstract

In the modern era, all companies have become interested in the expansion of business sectors and the diversity of their activities and keeping pace with all developments that occur in the world, especially in the fields of technology and economics, as this development has become a starting point for attention and development of internal control systems to organize the companies' business. This study aimed to know the company's internal control systems and their impact on the quality of financial reports for all companies in general, in addition to that, the study aimed to know the impact of internal audit and the control environment that fall under the components of internal control systems. In this study, questionnaires and interviews were used for data collection, as a sample of 80 people working was taken. After obtaining the results, the analysis was carried out using Microsoft software. The study reached many results, the most important of which is that there is a positive relationship between internal control systems and the quality of financial reports, as the more effective and efficient the internal control systems are, the higher the quality of the financial reports, as there must be strong internal control systems for the financial reports to be free from errors, manipulation, and embezzlement. The researcher also recommends the need to pay attention to internal control systems and financial reports and to put in place many plans and programs that help in developing them to prepare financial reports that are credible and reliable.

**Keywords:** internal control systems, quality of financial report, financial report, OETC  
financial reports

## Introduction

At present, the world is witnessing rapid developments in various sectors, especially the sector of production operations that companies and institutions are currently witnessing, as there is strong competition to move to modern developments and concepts in the field of manufacturing, services, and others. The economic advances and technological developments led to the emergence of a very large number of large international projects in all fields, especially industry, and this, in turn, led to the intensification of competition and at the same time led to an increase in interest in internal control, because it is considered one of the most important systems that help the company or institution to achieve All desired goals to be reached. Also, financial control is considered the most important basic function in the company or organization, due to its great role in excellence and continuity in the market, as it is the means that leads to the proper use of financial statements and reports. The quality of financial reports is one of the most important issues in all companies, as through its decision-makers, investors, and others can rely on them as ingredients and trust them. The quality of these financial reports is available through several standards, including legal, professional, and also supervisory, as through these standards these financial reports will be of great importance. Also, internal control has a major role in detecting errors or deviations that may occur in these reports, so there must be sound internal control systems.

## Research Objectives

- 1) To identify the application of the internal control system in the company and its impact on the financial statements.
- 2) To analyze the efficiency of the internal control systems applied in the company according to financial reporting standards.
- 3) To determine the means and methods that contribute to achieving the use of internal control systems to achieve the company's objectives.
- 4) To recommend proposals for strengthening the internal control systems to improve the quality of financial reports.

## Research Questions

- 1) What is the application of the internal control system in the company and its impact on the financial statements?
- 2) How efficient are the internal control systems applied in the company with financial reporting standards?
- 3) What are the means that contribute to achieving the use of internal control systems to achieve the company's objectives?
- 4) What are the recommendations for strengthening the internal control systems to improve the quality of financial reports?

## Statement of the Research Problem

The quality of financial reports is important for all investors, government agencies, auditors, as well as owners, as it is highly dependent on the financial reports that have been published whenever they are of high quality and reliable by users.

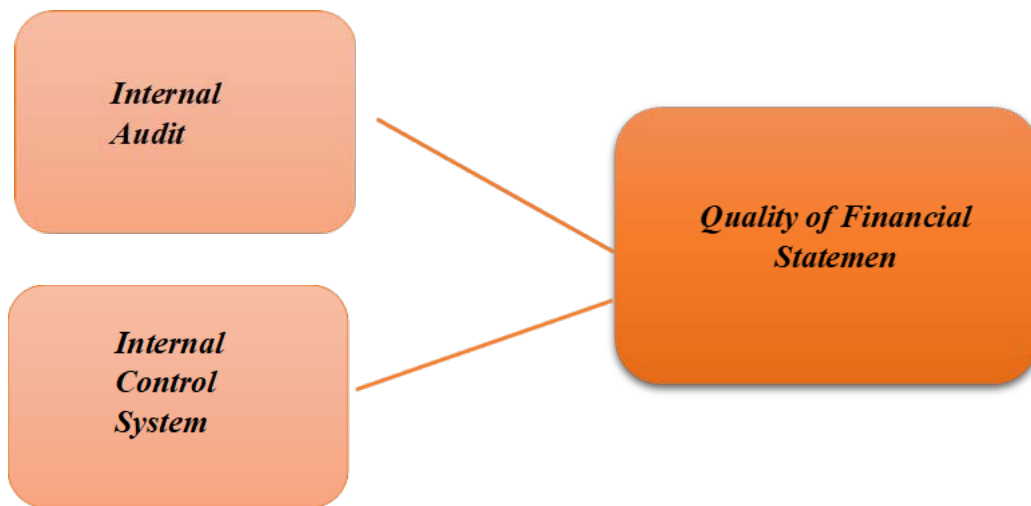
Internal control systems are considered one of the important management accounting methods at present, which have a great interest by companies and institutions due to economic developments, especially in production systems, as they are considered one of the important ingredients for the advancement of the company or institution and access to the goals it aspires to, and that Because these systems provide positive effects in protecting assets from theft or misuse, and thus may lead to their loss.

The weakness of the financial control systems negatively affects the company or the institution and thus this leads to the poor quality of the financial reports and poor data or manipulation of data or information, and some people may be alone in making decisions without any laws governing them, this is reflected on the financial position of the company. The main problem of this study is the impact of internal control systems on the quality of the financial reports.

## LITERATURE REVIEW

### Theoretical Framework

Internal control systems and the quality of financial reports



*Figure 1 Internal control systems and financial reporting*

Internal control systems consist of control, control activity, control environment, information and communication, and risk assessment. As the results indicate that the internal control systems have an impact on the quality of financial reports, through the presence of weaknesses in the internal control systems that negatively affect the financial reports, according to the internal audit function. In addition, effective internal control systems in the company evaluate the efficiency and effectiveness of financial reports, and there must be continuous encouragement to improve the internal control systems (Investopedia,2022). The internal control systems enhance management decision-making to encourage transparency and accountability in financial reports, and the weakness of internal control systems has an impact on the low quality of financial reports. Moreover, to achieve an effective, efficient and transparent financial system, all activities must be implemented following the internal control systems (Law insider,2022).

The internal audit is effective in detecting fraud, manipulation, and fraud in the financial reports, as well as the internal audit, can improve the environment of the internal control systems, and thus this will be reflected in the financial reports by reducing errors and reporting fraud and fraud. The internal audit and internal control systems have a positive impact on the quality of financial reports.

## **Internal control systems and their impact on financial statements**

According to Kato et.al. (2019) The study aimed to measure the effectiveness of internal control systems and capital management for major centers and their financial status. The study sample consisted of 110 shops in Uganda, as the results of the study concluded that capital management is a necessary indicator of financial performance. This indicates that having good capital management contributes significantly to having good internal control systems that help enhance financial performance. In addition, these results may contribute to the development of working capital policy. However, the internal control system, as well as capital management, is still limited in many commercial centers (Kato et.al.,2019).

Acknowledged Adegboyegun et.al. (2020) The study aimed to discuss the internal control systems and the level of operational performance of a group of medium and small companies in Ondo State. The study included 120 medium and small companies. The results of the study were compiled and arranged by the "Logistic Regression Estimation Scale", and the results appeared as follows: The high level of operational performance of medium and small enterprises in terms of annual profitability rises very slightly, as it reached 0.78% and 1.95% And it decreased slightly by 53.53%, 0.51% and 0.33% sequentially with the measure of improvement in communication, information and control activities and in the division of risks. The study also confirmed that the internal control systems do not have any impact on the operational performance of small and medium-sized companies (Adegboyegun et.al.2020).

Argued Dewi et.al. (2020) This study aimed to determine the impact on government accounting standards, internal control systems, and the use of information technologies for the quality of financial data and the efficiency of human resources. The results indicated that the efficiency of human resources and accounting standards do not affect the quality of financial reports. As for the internal control system and the use of information technologies, they significantly affect the quality of financial reports (Dewi et.al.,2020). This study aims to know the impact of the efficiency of human resources, the internal control system, and the use of information technology on the value of financial reporting information for the government in the Sokoharjo region. The number of samples that were used in the study reached 69 respondents, and data was collected through questionnaires on many institutions in the Sokoharjo region for the departments of finance and accounting. The results of this study concluded that the use of information technology and the efficiency of human resources do not have a significant impact on the

financial reports. As for the internal control systems, they have a positive and important impact on the financial reports.

The Sarbanes-Oxley Act of Management and Auditors states that Sections 404A and 404B require reporting on the effectiveness of internal control over a company's financial reporting. Whereas, large companies were asked to submit a set of management reports and conduct an external audit of ICFR's financial reports in 2004. Also, in 2007, small companies were required to report an administrative report for financial reports, but they were exempted from the certification requirements. It was found that administrative reports on financial reports have an impact on improving the quality of these financial reports, and it has been proven that they have many benefits for preparing financial reports (DowdellJr,2020).

Accuracy in the financial statements and the possibility of relying on them is one of the most important objectives of the internal control systems, as the responsibility for preparing the financial statements used by investors and auditors lies with the management, and through this, the financial statements included in the financial reports must be credible and be following the procedures of the regulations Internal Control. The internal control systems have a significant impact on the credibility of the financial statements, as there is a relationship between them. The more effective and good the internal control systems are, the more credible the financial statements will be. In his study on a commercial store in Uganda, researcher Kato confirmed that the quality of good internal control systems will contribute to improving financial performance through financial statements that are in line with internal control systems (Kato et.al.,2919). researcher Dewi added to him in his study that internal control systems and information technology have a significant impact on the quality of financial data (Dewi et.al.,2020). While researcher Adegboyegun indicated, through his study of small and medium-sized companies, that internal control systems have no impact on operational performance, through his findings (Adegboyegun et.al.2020).

### **Efficiency of internal control systems in accordance with financial reporting standards**

Asserted Abisola et.al. (2022) In all countries of the world, economic development depends on the extent of the stability of the banking industry in the country, because it is the banking industries that enhance the culture of saving among people and help in financing capital, in

addition to encouraging and facilitating international trade. This study examined the impact of the size of the bank on the financial performance of depository banks in Nigeria (DMBN), in addition to the fact that this study included the impact of the efficiency of internal control on the relationship between the size of the bank and financial performance. The obtained data was analyzed using descriptive and productivity statistics. The results of the analysis showed that the bank's size agents (number of employees, customer deposits, total assets) have a cumulative effect on assets for financial performance, in addition to the fact that the efficiency of the internal control systems enhanced the impact of the bank's size on Financial performance. Also, this study worked on summarizing the total number of employees and deposits of clients, as they are agents of the size of the bank, which has a common effect on the financial performance, and that the efficiency of the internal control systems has an impact on the size of the bank and the financial performance (Abisola et.al.,2022).

Declared Atheru et.al., (2022) Through internal audits of institutions, misuse of funds can be eliminated and thus achieve positive financial performance, and the inefficiency of internal control systems and insufficient controls led to the complicity of management and all auditors, and thus this leads to the failure of companies to achieve goals. The financial performance of DT - SACCO Company suffers from a very large lack of internal financial control, and this is the reason for the continuation of lending more than deposits, and this in turn led to the destruction of liquidity. This study worked in pursuit of the effect of internal control systems for credit and saving cooperative societies by taking deposits. As this study aimed to know the impact of the control environment on the financial performance of credit and saving cooperative societies and the impact of control systems on financial performance. This study focused on the importance of the internal control system on financial performance, and the results concluded that effective internal control systems are the ones that encourage employees to adopt high financial integrity, taking into account the values of financial adequacy and observance of ethics, in addition to that all employees in companies and associations must enjoy high efficiency. The ability to enhance productivity and the ability to conduct appropriate processes for internal control systems operations (Atheru et.al.,2022).

According to Zhang et.al.,(2020) The new era is witnessing an active development in the market economy, as there has become great competition between many different industries, as there are more costs of huge competition and operating costs of companies, which leads to the existence of a huge background of financial data, and the model of the financial services system is a new type of system Financial management, as if the institution was not able to exclude effective effective

internal control systems, this may lead to significant losses for stakeholders. In the presence of the huge background of data, the provision of effective and efficient internal control systems is a strong guarantee for the company in order to operate the financial participation services (Zhang et.al.,2020).

Acknowledged Shu et, al., (2021) This study examines the relationship between the company's integrity and the existence of internal control systems, as the results show that the company's integrity has a significant and negative correlation with internal control weaknesses. When the legal development or competition in the market is weaker, the negative correlation between the integrity of the company and the internal control systems will become more important, in addition, it was found that the corporate governance that is more effective can enhance the relationship between the integrity of the company and the quality of the internal control systems, and the results indicated that the integrity of the company It can improve the quality of internal control systems (Shu et.al.,2021).

The development of highly efficient internal control systems in line with financial reporting standards helps the company achieve its goals, as the internal control systems contain many policies and procedures that are designed to comply with financial reporting quality standards. The internal control systems are efficient in working to protect and preserve financial reports from embezzlement and theft. The researcher, Abisola, addressed in his study, which included the impact of the efficiency of the internal control systems and their relationship to financial performance, as he explained that the efficiency of the internal control systems enhanced the impact of the size of the bank in terms of financial performance (Abisola et.al.,2022). The researcher Atheru agreed in his study that internal audits and the efficiency of internal control systems led to the elimination of misuse of funds and thus this leads to positive financial performance, meaning that the financial reports are reliable and credible (Atheru et.al.,2022). This was confirmed by researcher Zhang. If the institution does not have efficient internal control systems, this may lead to large losses for the company (Zhang et.al.,2020). Researcher Shu added to him that there is a relationship between the integrity of the company and the efficiency of the internal control systems. His results concluded that the company's integrity has a negative relationship with the weakness of the internal control system (Shu et.al.,2021).

## **Research Methodology**

Research methodology is how the researcher designs the research in a systematic way for a particular study in order to obtain reliable and valid results that address the objectives of the



research in addition to the methods used in data collection (Grad Coach, 2020). In this study, the type and nature of the study will be discussed in addition to the population and samples, as well as data collection tools, as it is necessary to take into account their validity and credibility, and all procedures that would be used to collect information and data in this study. It will also focus on the research method that will be used in this study, which aims to achieve all the objectives that have been identified.

## **Research Design**

Research design is the research methods and techniques that the researcher chooses. Research design is an important part of the research for the reliability of the research results, as the research design allows researchers to focus on appropriate research methods to prepare their study and reach success (Question pro,2022). In this study, the questionnaire will be used, as the questionnaire questions will contain many closed questions (yes, no, agree, disagree, etc.) and open questions through which the respondents can express, and through the questionnaire questions, the researcher can collect many from the various answers to the research questions.

A specific strategy will be used in the research, as it will be divided into data collection and analysis. In this study, descriptive and exploratory research approaches will be used. The descriptive research approach is one of the ways to study a scientific problem by doing the description in scientific ways and reaching explanations that have many evidence and proofs, as the researcher can develop frameworks for the problem and this is used by defining the research results. The exploratory research approach is the one that aims to form a vision about any problem that the researcher may face, as it can determine the extent of the need for other future research on the specific problem. The researcher will seek to accurately define the problem, by collecting data related to the topic of the research (Voxco, 2022).

## **Sampling Technique**

Sampling is a process used for statistical analysis by taking a specific number of people from a population. The methodology that is used in sampling depends on the type of statistical analysis that will be used. Researchers use two types of sampling methods: probability and non-probability sampling.

- Non-probability sampling:

Non-probability sampling is one of the methods for selecting samples from the population in a non-random manner to participate in the research. It is a quick and easy way to take data as well as inexpensive. As non-probability sampling does not have all members of the community equal opportunities to participate in the study, in addition to that non-probability sampling is one of the most beneficial of exploratory studies (questionpro,2022).

## **Sampling Size**

The sample size is the number of individual samples included in the research study in order to represent a group of the population. The sample size is also what indicates the total number of respondents in this research study. Determining the appropriate sample size is very important, as a very small sample gives unreliable and often incorrect results, and a very large sample also requires a lot of time and may increase costs and resources (geo poll,2022).

In this study, the employees were divided into groups according to their different jobs, then samples will be taken randomly from all groups of individuals who work in the financial and human resources management of the company. Each group has a certain number of individuals, 80 of whom were selected, and the groups were divided into functional cadres, namely, the upper management (managers and officials) and the lower cadre (employees) to save time, effort, and cost. The questionnaire was given to the managers and employees of the company.

## **DATA ANALYSIS**

Quantitative research is the process of collecting and analyzing numerical data. Quantitative research is used to identify the problem that lies in generating numerical data that will be converted into statistics and can be used as part of the inquiry, as well as used until variables, attitudes, and behaviors are identified, patterns and averages are obtained, causation is tested, and predictions are used to generalize the results to a large sample of the population (Dovetail,2022). Digital data is collected through many methods, including surveys, which are, for example, paper or online surveys, as well as face-to-face or remote interviews. Once the data is collected, it is processed until the analysis process is confirmed (Scribbr,2021).

*Table 1 internal control systems*

Answer choice ▾	Responses ▾	Percentage ▾
Strongly disagree	11	22%
Disagree	3	6%
Neutral	12	24%
Agree	19	38%
Strongly agree	5	10%
Total	50	100%

The above table (1) show whether the company uses the reports provided by internal control systems to develop work and address deficiencies. The results indicate that those who agreed was the highest percentage and amounted to 38%, and those who agreed strongly were 10%, and this is for reasons, including that the internal control systems are effective contributors to the development of work and address the deficiencies that occur in the financial reports, through the effective role it plays in its performance to obtain Accurate and reliable financial reports. While the percentage of 24% represented the neutrals who sometimes agree that the internal control systems have a role in developing work and addressing the shortcomings that occur, and sometimes they do not agree. While the percentage of those who did not agree strongly amounted to 22%, and those who did not agree to 6%, and this may be due to several reasons, including that the employees do not care about the reports provided by the internal control systems to know the shortcomings, address them and develop their work, or it may be from the company because the internal control systems are not efficient High. Therefore, the reports submitted by the internal control systems are considered an important part to address the shortcomings, as they help in identifying errors that may occur in the reports and financial statements, and thus this leads to the development of work in the company (Mgallp,2018).

*Table 2 Effective control systems*

Answer choice ▾	Responses ▾	Percentag ▾
Strongly disagree	10	20%
Disagree	10	20%
Neutral	13	26%
Agree	11	22%
Strongly agree	6	12%
Total	50	100%

The above table (2) show whether the company uses effective internal control systems that contribute to the protection of financial reports from theft and fraud. The results indicate that the highest percentage, which amounted to 26%, was neutral, as in some cases they see that the use of effective internal control systems has a role in protecting financial reports from theft and fraud, and in some cases not, while 12% strongly agreed and 22% agreed and this may be It suggests that effective internal control systems have a positive impact as it protects financial reports from thefts and embezzlement and thus increasing the quality of financial reports enhances investment efficiency and this, in turn, leads to the achievement of the company's goals. Likewise, the percentage of those who disagree and strongly disagree is equal, reaching 20%, and this may be due to many reasons, including the employees' lack of interest in internal control systems and the quality of financial reports, or from the company due to failure to follow correct and effective internal control systems. Thus, effective internal control systems contribute to reducing the risks of fraud and manipulation and increasing confidence in financial reports, in addition to contributing to achieving company goals and improving the quality of its financial reports (Small business, 2022).



## **Conclusions**

Finally, the focus of this research is the impact of internal control systems on the quality of the financial reports in the Oman Companies. Through this research, it became clear that companies are interested in internal control systems because of their significant impact on improving the quality of financial reports and thus achieving the company's goals. In addition, the more effective the internal control systems are, the more honest, reliable, and free from fraud, theft, and other financial reports. Several recommendations will be presented about the importance of internal control systems on the quality of financial reports, which will benefit the development of work in the future.

## Recommendations

- Establishing good and effective internal control systems and monitoring them by the company to conduct business in an efficient and orderly manner to enhance the efficiency of the financial reports to provide them free of errors, honest, reliable, and of the best quality.
- Continuously developing internal control systems in the work environment in line with the company's developments to address shortcomings or problems facing financial reports, as problems are linked to internal control systems to help them find solutions.
- Training the cadres who prepare the financial reports in the company in line with recent developments in the internal control systems to expand their knowledge and experience in the procedures and policies of the internal control systems so as not to misuse them or prepare them incorrectly.
- Evaluate all risks that the company may face continuously by the internal control systems to bypass and control them so as not to affect the nature of the work, especially during the preparation of financial reports.
- The need to develop several emergency plans and programs aimed at the effective and efficient functioning of financial reports in the event of a weakness in the internal control systems, to prevent the occurrence of manipulation, embezzlement, and thefts that lead to the occurrence of major errors in the financial reports, which weakens their quality.
- Attention to creating an effective control environment to efficiently achieve the company's goals, and to follow the latest methods and models for internal control systems that help them prevent fraud.

The use of internal control systems to detect errors and deviations that occur in financial reports through strong control that helps in detecting them early without any complications, which helps to save time and effort. Internal control systems work to help make decisions properly and develop a set of successful strategies for the company by providing financial reports that are reliable and honest. In addition, it helps raise the level of the company's performance through the presence of strong and effective internal control systems, which gives it security in improving the quality of its financial reports.

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