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The effect of the internal audit on the accounting disclosure in Jordanian banks

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Abstract:

This paper focuses on identifying most in influencing factors of internal audit on the accounting disclosure in Jordanian Commercial Banks (JCBs). The perceptions of JCBs' internal auditors have been investigated. In general it was found that the respondents believe that the role of the internal auditor in the accounting disclosure in the Jordanian banking sector ranges from satisfactory to very good. The results indicate a positive and significant correlation between accounting disclosure and the proficiency of auditor. The results of this study make a contribution to existing literature in the area of factors affecting the role of the internal auditor in the accounting disclosure in eastern developing countries such as Jordan. In addition, this research adds further evidence to the value of studying auditing efficiency.

Keywords:

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INTRODUCTION

The purpose of this study is to examine the effect internal audit on the accounting disclosure , my study is based on the view that audits reduce information asymmetries resulting from policies of limited disclosure by conveying credibility to the financial reports. .Mercer (2004) notes that: Internal auditors often serve as the first line of defense against disclosure errors, ferreting out unintentional errors caused by weaknesses in a company's internal controls and intentional errors due to fraud.

Consequently, if investors can assess internal audit quality, then firms with a strong internal audit department may have higher disclosure credibility.

Professional standards and prior research (AICPA 1991; IIA 2008; Prawitt et al. 2009) suggest that internal audit quality encompasses specific attributes of the organizations and parties performing internal audit activities e.g., competence of internal audit personnel, as well as the nature and scope of activities performed e.g., the extent to which internal audit monitors remediation of previously identified control problems. Similarly agency cost theory would suggest that managers rent the reputation of a high quality auditor in order to lend credibility to their disclosures and avoid costs of nondisclosure Jensen & Meckling (1976).

Prior research suggests firms can increase the value of the firm by increasing voluntary disclosures (e.g., Diamond and Verrecchia 1991; Barry and Brown 1985, Fishman and Haggerty 1989). Given these benefits firms have incentives to increase disclosure and employ high quality auditors as complements to increase the value of the firm.

However, managers also face the threat of disclosing proprietary information to competitors as well as the presence of information uncertainty when selecting the firms' level of disclosure (e.g., Verrecchia 1983; Gigler 1994; Dye and Sridhar 1995). Thus, in practice we observe less than full disclosure. Lower disclosure levels would require the employment of alternative signaling mechanisms such as the employment of specialized auditors in order to avoid the costs of nondisclosure.

This study makes several important contributions. First, examined the impact of internal audit in terms of the efficiency of the auditor on the accounting disclosure . Few studies have taken internal audit on the disclosure.

Secondly, and finally, we provide evidence that internal auditors are more likely to detect material weaknesses. While a significant branch of the internal auditing literature focuses on the relation between internal auditors and the accounting disclosure .

Section II provides background information and reviews relevant literature, Section III describes our hypotheses, and Section IV describes the sample and model. Results are discussed in Section V, with concluding remarks in Section VI.

2- BACKGROUND AND LITERATURE REVIEW

Accounting disclosure

Corporate disclosure is a channel through which the existing and potential shareholders can obtain valuation information regarding the firm. It is also the connection between corporate insiders and capital market investors. Therefore, if there is new information; it cannot remain undisclosed as it should be disclosed either mandatory or voluntary Al akra et al., (2010).

Prior research suggests firms can increase the value of the firm by increasing voluntary disclosures (e.g., Diamond and Verrecchia 1991; Barry and Brown 1985, Fishman and Haggerty 1989). However, managers also face the threat of disclosing proprietary information to competitors as well as the presence of information uncertainty when selecting the firms' level of disclosure (e.g., Verrecchia 1983; Gigler 1994; Dye and Sridhar 1995). Thus, in practice we observe less than full disclosure.

So the effect of corporate disclosure as a connection between managers and shareholders involves the association of management power and shareholder variation. It characterizes the link between corporate

governance and information asymmetry through the compound relationships between corporate governance and corporate disclosure, and corporate disclosure and information asymmetry Yifang, (2009).

Several major corporate scandals rocked international businesses throughout 2001-2003 and were followed by corporate collapses, such as Enron Corporation in the US, Coloroll, Polly Peck, BCCI and later Barings in the UK, Parmalat in Europe and HIH Insurance Ltd in Australia (Mallin, 2011; Mallin et al., 2005; O'Sullivan et al., 2008). As a result, tighter regulations, codes, and principles of corporate governance came into force in response to these scandals (Aras and Crowther, 2008; Bury and Leblanc, 2007).

The role of internal audit

the internal audit function is a potential source of information that may lend disclosure credibility. Internal auditors often serve as the first-line of defense in preventing errors and detecting fraud Mercer, (2004). An adequately structured internal audit function has the capacity to discover and correct problems before they grow large. However, there is little empirical evidence linking internal audit strength and disclosure credibility due to lack of information available about companies' internal audit function, holt, (2012) .

According to assurance theory (Mautz and Sharaf, 1961; Libby, 1979; Libby et al., 2004), individuals perceive audited information to be more credible than unaudited information.This increase in perceived credibility results from a perception that more evidence gathering is required in order to provide the assurance. By its very nature, the shift away from assurance services to consulting services reduces the amount of evidence gathered internal audit resulting in a lowered level of assurance offered by the function.

Additionally, an internal audit function whose activities are primarily consulting-related may be perceived as lacking objectivity. During consulting projects, internal auditors often work closely with management Breakspear, (1998). These working relationships may lead to perceptions of objectivity impairment for the internal auditor, as the internal auditor may be hesitant to report adverse findings Greenspan et al., (1994). Furthermore, internal auditors are often called upon to test their own work performed during SOX compliance implementation. This situation represents an inherent objectivity impairment Krell, (2005).

Studies provide useful archival evidence on the relation between auditor disclosure and the detection, neither directly addresses internal auditor quality. Research on the effects of third- party monitoring on management reporting is also relevant to internal auditing (Prawitt et al. 2009; Hoitash et al. 2009) find that greater accounting and financial supervisory experience on the audit committee is associated with a lower likelihood of Section disclosures. Studies of management forecasts and communications show that management is less biased when their bias is likely to be perceived by others (Schwartz and Young 2002; Rogers and Stocken 2005). Brown & Pinello (2007) provide evidence that the annual reporting process, which calls for an external audit, mitigates earnings management in year-end reports relative to that in interim reports. They attribute this result, at least in part, to increased scrutiny of year-end reports. Accordingly, if the internal auditor function is viewed as a third party that monitors managers' actions on a year-round basis, then improvements in internal audit quality should strengthen deterrence and detection mechanisms.

Practitioners and academics alike generally contend that the effectiveness of internal controls is increasing in internal audit quality. However, direct empirical evidence of this relation is limited e.g.,(AICPA 1991; Kinney 2000; Bailey et al. 2003; Gramling et al. 2004; PCAOB 2007a; Prawitt et al).

Beatty (1989) shows that audits conducted by prestigious firms were associated with lower share offering discounts for companies seeking a stock exchange listing for the first time. Similarly, Hogan (1997) shows that the owners of businesses must choose between accepting greater underpricing and providing more credible financial information by means of an auditor of higher standing .

This evidence supports the premise that the internal audit has a positive effect on accounting disclosure and provides assurance that the observed disclosures are a fair and accurate portrayal of the firm's pertinent

activities at a given point in time. This leads to our hypothesis:

H 2: The independence of the auditor effect on the accounting disclosure in the Jordanian banking sector.

H3: Auditor efficiency effect on the accounting disclosure in the Jordanian banking sector.

3- Methodology

Research design

The research design is the master plan specifying the methods and procedures for collecting and analysing the needed information Zikmund, Babin, Carr, & Griffin,(2009). The quantitative approach was used in this study to determine the association between internal audit and accounting disclosure .Data used in this study will be obtained from a questionnaire survey. With regards to data analysis, this study used various statistical analysis to obtain meaningful information. Statistical Package for the Social Sciences (SPSS) used to analyze the data.

Sample

The study's participants were Internal Auditors in jordan banks have used the jordan banks Because it is the largest sector size for trading on the Amman Financial Market , He was taking responses the Internal Auditors Because they are fully aware what is happening in Their work.

Has been getting a number of Jordanian banks of the Amman Stock Exchange and the site was the 16 Bank of Jordan as in Table 1, was then asked via e-mail to volunteer to answer questions study, Randomly distributed questionnaire .

Table 1 Banks in Jordan

no	Bank name	Distribution
1	Arab bank	7
2	Abc bank	4
3	Bank of Jordan	5
4	Cairo Amman bank	6
5	capitalbank	3
6	Jordan Commercial Bank (JCBANK)	5
7	Jordan Kuwait bank (JKB)	4
8	Jordan ahli bank	5
9	Housing bank (HBTF)	6
10	Arab Jordan investment bank (AJIB)	5
11	investbank	6
12	Society general (SGBL)	5
13	Bank al Etihad	6
14	Safwa Islamic Bank	6
15	Jordan Islamic bank	7
16	Islamic international Arab bank	5
	Total questionnaires distributed	85

Data Collection Methods

This research adopted questionnaire method as a mean for data collecting to examine affect the internal audit on the accounting disclosure . This survey consists of the two parts:

Part 1: general information about the sample of the study.

Part 2: questions about effect internal audit on the accounting disclosure. This survey was distributed over Internal Auditors in Jordanian banks

4- Results

Descriptive Statistics

Based on the following table we can make the following observations:

The number of observations (respondents) for each variable was 85, which reflect that the respondents have answered all questions concerning study variables.

The average value for audit quality was 74.4%, indicating that the respondents believe that audit quality in the

Jordanian banking sector the effects on the accounting disclosure.

The average value of the independent variables ranged from 70% to 84%, which means that the respondents assume that audit quality is highly affected by those variables on the accounting disclosure . Standard deviation for all variables was relatively low, which indicate that the respondents" answers are consistent and close to each other.

Table (2): Descriptive Statistics for Study Variables

	N	Minimum	Maximum	Maximum	Std. Deviation
Independ Efficiency	85	.68	1.00	.8321	.07555
	85	.68	1.00	.8406	.08082

Regression Analysis

Linear regression estimates the coefficients of the linear equation, involving one or more independent variables that best predict the value of the dependent variable. In the following sections we will presents the results of regression analysis for study model.

1. Regression Analysis for Model (1)

The first model examines the effect of all independent variables on accounting disclosure without the dummy variable.

Table 2 presents the results of this regression.

Table (3): Regression Results

$$DA = a + B1\ Independ + B2\ Efficiency + E$$

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.826a	.682	.654	.01099	2.124

a. Predictors: independ, Efficiency
b. Dependent Variable : accounting disclosure

ANOVA

Model		Sum of Squares	df	Mean Squar	F	Sig.
1	Regression	.020	7	.003	23.639	.000a
	Residual	.009	77	.000		
	Total	.029	84			

a. Predictors: independ, Efficienc

b. Dependent Variable: accounting disclosure

Coefficients

Model	Unstandardized Coefficient		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 independ	.028	.018	.113	1.536	.129	.755	1.324
Efficiency	.042	.017	.183	2.478	.015	.756	1.324

a. Dependent Variable : accounting disclosure

Based on the above table we can conclude the following:

- R^2 was 68% and adjusted R^2 was 65%, which reflects the explanatory power for independent variables to explain about 65% of the changes in the dependent variable accounting disclosure
- Durbin-Watson statistic (which was 2.12) indicates that there is no serial correlation (autocorrelation) in the dependent variable, since it is so close from the optimal value (2).
- F-statistic and its significant denote the goodness of fit. In other word, f-statistic indicates that the model is properly specified to reflect the effect of independent variables on the dependent variable.
- The results indicate that Efficiency effect (at 5% significant level) of Audit; while the other Variable seem to have no effect on accounting disclosure.
- Finally, variance inflation factor (VIF) was too low for independent variables, indicating the absence of multicollinearity problem.

Moreover, to exclude insignificant variables that might affect the results negatively, we utilize stepwise regression analysis. Stepwise regression is a method selection option that allows specifying how independent variables are entered into the analysis. According to this method, stepwise variable entry and removal examines the variables in the block at each step for entry or removal. At each step, the independent variable not in the equation which has the smallest probability of F is entered, if that probability is sufficiently small. Variables already in the regression equation are removed if their probability of F becomes sufficiently large. The method terminates when no more variables are eligible for inclusion or removal.

Table 4 shows the results of stepwise regression.

Table (4): Stepwise Regression Results

$DA = a + B1\ Independ + B2\ Efficiency + E$

Model Summarye

Mode	R	R Square	Adjusted R Square	Std. Error of The Estimate	Durbin Watson
1	.817a	.667	.650	.01104	2183

a. Predictors: (Constant) Efficiency

b. Dependent Variable: accounting disclosure

ANOVAe

Model	Sum of Squares	df	Mean Square	f	Sig.
1 Regression	.020	4	.005	40.046	.000
Residual	.010	80	.000		
Total	.029	84			

a. Predictors: (Constant) Efficiency

b. Dependent Variable: accounting disclosure

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1(Constant)	.596	.015		39.503	.000		
Efficiency	.048	.016	.207	2.933	.004	.837	1.194

a.   Dependent Variable: accounting disclosure

Based on Table 3 we can conclude the following: The analysis Sample models as follows:

Accounting disclosure = a + B1 Efficiency

These models include the variable that affect accounting disclosure Other variable were eliminated because they are not significant and affect another variable negatively.

- Was R2 66.7% which reflects the power the independent variable .
- Durbin-Watson statistic (which was 2.18) indicates that there is no serial correlation (autocorrelation) in the dependent variable, since it is so close from the optimal value (2).
- F-statistic and its significant denote the goodness of fit for model (a). In other word, f-statistic indicates that the model is properly specified to reflect the effect of independent variable on the dependent variable.
- The results indicate that Efficiency have a positive and significant effect (at 1% significance level) on accounting disclosure.
- Finally, variance inflation factor (VIF) was too low for independent variable indicating the absence of multicollinearity problem.

Results of Hypothesis Testing

Based on the above discussion, we can summarize the results of hypotheses testing as shown in table 5

Table (5): Results of Hypotheses Testing

NO	Hypothesis	Result
1	The independence of the auditor effect on the accounting disclosure in the Jordanian banking sector.	Reject
2	Auditor efficiency effect on the accounting disclosure in the Jordanian banking sector.	Accept

5. Conclusions and Recommendations

Based on the results, the researchers conclude the following:

1. Standard deviation statistics for all variables were relatively low, which indicate that the respondents" answers are consistent and close to each other.
2. The weighted average score for the role internal audit in accounting disclosure was 3.72 out of five (about 74%), which indicates that the respondents think that the role internal audit in accounting disclosure in the Jordanian banking sector ranges from satisfactory to very good.
3. The results confirmed the existence of a positive and significant correlation between internal audit efficiency and accounting disclosure .
4. The results indicate that Efficiency that have a positive and significant effect (at 5% significant level) on auditing quality, while the independent auditor seem to have no effect.

Based on study conclusions, the researchers recommend the following:

1- The role internal audit in accounting disclosure in the Jordanian banking sector ranges from satisfactory to very good. This requires the of Jordanian banks increase the role of the internal auditor in the accounting disclosure.
2- Increasing auditing efficiency leads to increase accounting disclosure quality. So, auditors should have degree in his specialty field, and a necessary work experience will effect on his efficiency, and strong knowledge and familiarity with the regulations, instructions and standers which relating to the accounting and auditing position will benefit the auditor in his work, on the other hand the training and developing the skills of the auditor during participate in programs, and to know the development technical's way to discover the fraud and counterfeit, and trying to get professional certificates like CPA…etc all of that will enable him to improve his quality of work.
3- Auditors should seek to maintain higher level of specialty in auditing through participating in special seminars and training will add to the auditors more experience to his field and increase his qualification, meeting with people who are specialization in auditing filed will benefit and affect positively on his proficiency, therefore the professional auditor should know the banking policies, rules, restrictions" and directions for use it.
4- Future research study recommends that another sector.

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