

Evaluation of the Internal Control System by the External Auditor and Its Impact on the Financial Performance of the Organization: An Applied Study

ABID Adel Islem *

***Laboratory of : Gouvernance Publique et
Economic Social
University of ABOUBAKAR BELKAID
(ALGERIA)
adelislem.abid@univ-tlemcen.dz***

IBRIR Meryem El Batoul

***Laboratory of : Management of people and
organization
University of ABOUBAKAR BELKAID
(ALGERIA)
meryemelbatoul.ibrir@univ-tlemcen.dz***

Received: 18/01/2025

Accepted: 28/04/2025

Published: 30/06/2025

Abstract :

The research investigates the role of external auditors in strengthening organizational financial oversight through a systematic evaluation of internal control systems. Using a descriptive-analytical methodology and an applied study, the research analyzes audit reports and financial statements from a selected company from the Algerian market to assess control deficiencies and their impact on financial performance. The study highlights key weaknesses, such as inefficient asset management and inadequate receivables handling, which expose organizations to financial risks. Based on these findings, external auditors provide strategic recommendations, including improving coordination among departments, enhancing regulatory compliance, and implementing automated monitoring systems. The results confirm that reinforcing internal controls minimizes fraud risks, enhances the accuracy of financial reporting, and fosters long-term financial stability. By integrating these recommendations, organizations can improve operational efficiency and strengthen governance practices.

This study underscores the critical role of external auditors in promoting financial transparency and ensuring compliance with evolving regulatory frameworks.

Keywords: External Auditor , Internal Control System , Financial Performance, Risk Management .

JEL classification codes: M42 ; M41 ; G30 ; G32

* **Corresponding author ABID Adel Islem ; adelislem.abid@univ-tlemcen.dz**

Introduction

The effectiveness of an organization's internal control system plays a critical role in safeguarding assets, ensuring the accuracy of financial information, and promoting operational efficiency. In this context, the external auditor serves as a key player in evaluating the internal control system and identifying potential weaknesses that could impact financial performance. Through their independent and objective assessments, external auditors provide valuable insights into the adequacy of internal controls, helping organizations to mitigate risks, reduce errors, and improve overall financial stability.

An effective internal control system is essential for preventing fraud, ensuring compliance with policies, and enhancing the reliability of financial reporting. However, many organizations face challenges in maintaining robust control mechanisms, particularly in environments that are undergoing financial or operational changes. The external auditor's role extends beyond verifying the accuracy of financial statements; they also assess whether internal control procedures are properly designed and effectively implemented to support sustainable financial performance.

By identifying gaps in the internal control system and providing actionable recommendations, external auditors contribute to enhancing financial performance in several ways. They help organizations optimize cash flow management, improve debt collection processes, and ensure accurate financial reporting. Additionally, external auditors promote accountability and transparency within organizations, fostering a culture of continuous improvement and risk management.

This paper aims to explore the role of external auditors in improving financial performance through the evaluation of internal control systems. It will focus on how auditors assess key areas such as asset management, customer account monitoring, and treasury management, and the impact of their recommendations on financial stability and operational efficiency. The study highlights the importance of implementing strong internal controls to ensure that organizations are well-positioned to address financial challenges and achieve long-term success.

Research Problem

Based on the above, and to comprehensively address the topic, the following research problem can be formulated:

To what extent does the external auditor contribute to improving financial performance through the evaluation of the internal control system?

Research Hypotheses

To answer the proposed research problem, the following hypotheses were developed:

- The external audit contributes to identifying the necessary tools and procedures to prevent errors and fraud.
- The external auditor's reports have a positive impact on the internal control system by guiding the organization in implementing their recommendations.
- The external auditor enhances the credibility and fairness of financial statements.

Research Objectives

The study aims to achieve the following objectives:

- To verify the validity of the proposed hypotheses.
- To highlight the role of the auditor in detecting accounting errors and fraud.
- To identify the procedures taken by the auditor to improve financial performance.

Research Methodology

To cover the various aspects of the study, answer the research problem, and verify the hypotheses, this research relies on the descriptive-analytical method. This method involves collecting, analyzing, and interpreting information and data related to the research topic to arrive at specific conclusions. Additionally, the study will employ a practical approach by applying the theoretical framework to real-world cases, focusing on the role of external auditing in improving financial performance.

Research Tools

The tools used in this study include books, conferences, scientific articles, and websites, as well as previous graduation theses relevant to the topic. Additionally, legal texts and academic journals will be used to support the research findings.

I. Literature review

Previous studies have explored the role and impact of internal control and auditing in preventing financial statement fraud, risk assessment, and ensuring the accuracy and reliability of financial data across different countries.

In Indonesia, (Ali Kadhim, 2018) examined how internal auditing and internal control prevent accounting fraud in the banking sector. The study found that both internal auditing and internal control positively impacted fraud prevention,

suggesting that greater efficiency in these systems improves the organization's ability to prevent fraud.

Another Indonesian study (**Ait Ovatiania and al, 2024**) , explored the relationship between internal auditor competence, internal control, and the prevention of fraudulent financial statements. The study revealed that auditor competence and internal control significantly contributed to preventing fraud and enhancing internal audit quality, boosting investor confidence in state-owned companies.

An exploratory study (**Afshan & Rengarajan, 2024**) , addressed the challenges and effectiveness of internal control systems. It found that internal control is essential for providing assurance on financial data accuracy and mitigating risks, though challenges such as fraud detection and human error remain.

Finally, (**Afshan & Aza, 2019**) emphasized the importance of internal control in auditing. The study concluded that effective internal control systems ensure reliable financial reports, compliance with laws, and safeguard organizational operations, contributing to overall organizational success.

II. General Concepts of Internal Control System

1. Definition of Internal Control System

Internal control systems are fundamental mechanisms within organizations that aim to ensure the accuracy of financial reporting, safeguard assets, and enhance operational efficiency. While the concept of internal control may vary across organizations, academic studies generally agree that internal controls encompass a set of policies, procedures, and practices designed to mitigate risks and achieve organizational objectives. According to Martin and Wallace (2021), an effective internal control system should address both preventive and detective measures to reduce the likelihood of errors and fraud (**Martin & Wallace, 2021, p. 27**).

Recent research highlights that internal controls are not merely technical processes but are part of an organization's overall governance structure. Effective internal controls rely on the coordination between management, employees, and governance bodies to ensure that policies are consistently applied across the organization. In their study, Kim and Lee (2020) argue that strong internal control systems foster a culture of accountability and transparency, which ultimately improves organizational performance (**Kim & Lee, 2020, p. 35**).

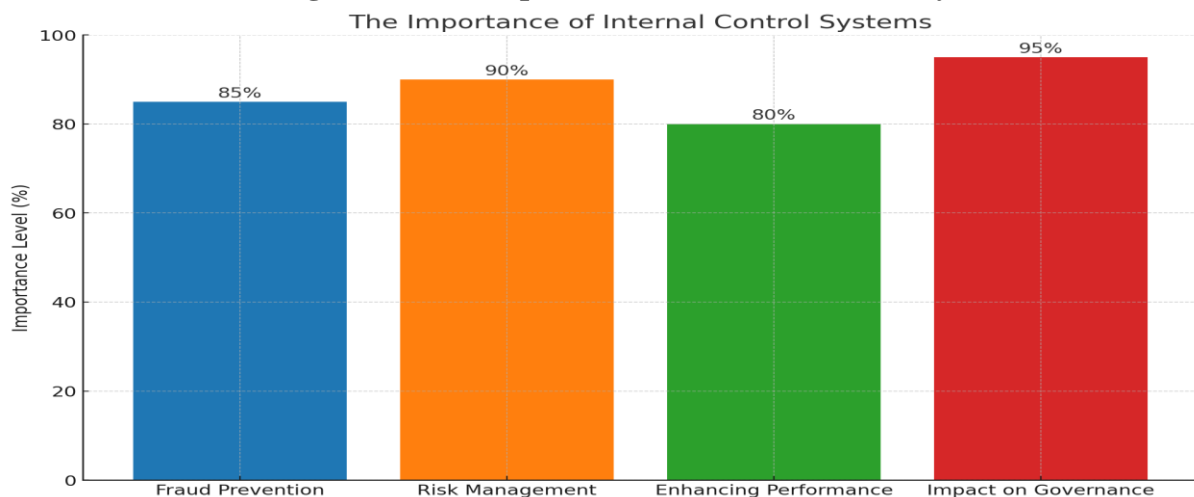
Another critical aspect of internal control systems is adaptability. As organizations face evolving risks and regulatory environments, internal controls must be dynamic and responsive to new challenges. Lopez and Garcia (2019) emphasize that continuous monitoring and assessment of internal controls are

necessary to ensure their relevance and effectiveness in mitigating emerging risks (Lopez & Garcia, 2023, p. 15). In addition to financial reporting, internal controls contribute to broader organizational goals, such as compliance with laws and regulations and safeguarding stakeholder interests. Smith and Jones (2022) note that internal controls extend beyond financial processes and include aspects such as cybersecurity, data protection, and environmental compliance (Smith & Jones, 2022, p. 50)

2. Importance of Internal Control Systems

Internal control systems play a pivotal role in the overall stability and sustainability of organizations. They provide a framework for safeguarding assets, ensuring accurate financial reporting, and promoting operational efficiency. The importance of internal control systems has been extensively discussed in academic literature, with researchers agreeing that such systems are essential for mitigating risks and enhancing corporate governance.

Figure 1 : The Importance of Internal Control Systems



source : Compiled by the researcher with the assistance of various sources.

1.1 The Importance of Internal Control Systems in Preventing fraud

One of the primary benefits of an effective internal control system is the prevention of fraud and financial irregularities. According to Johnson and Nguyen (2021), organizations with strong internal controls are better equipped to detect and prevent fraudulent activities. Their study found that companies with weak internal controls experienced higher rates of financial misstatements and asset misappropriation, highlighting the importance of robust controls in safeguarding organizational resources (Johnson & Nguyen, 2021, p. 40)

In addition to fraud prevention, internal control systems contribute to improving the reliability of financial reporting. Accurate financial reporting is essential for maintaining investor confidence and ensuring compliance with regulatory requirements. A study by Carter and Silva (2020) emphasized that

companies with well-implemented internal controls were more likely to produce reliable financial statements, which in turn led to lower audit risks and more favorable audit opinions (Carter & Silva, 2020, p. 28) .

1.2 The Importance of Internal Control Systems in Risk Management

Internal controls also play a key role in risk management. By identifying and mitigating potential risks, organizations can reduce the likelihood of operational disruptions and financial losses. In their research, Thompson and Evans (2019) argued that internal controls provide a structured approach to managing risks, allowing companies to respond proactively to emerging threats. This risk management capability is particularly important in today's dynamic business environment, where organizations face a wide range of financial, operational, and compliance risks (Thompson & Evans, 2019, p. 19)

1.3 The Importance of Internal Control Systems in Enhancing Performance

Furthermore, internal control systems enhance overall organizational performance. According to Kim and Park (2022), internal controls create a culture of accountability and responsibility, which improves employee performance and decision-making processes. Their study found that companies with strong internal controls reported higher levels of operational efficiency and productivity, as employees were more likely to adhere to established policies and procedures (Kim & Park, 2022, p. 52)

1.4 The Importance of Internal Control Systems and Its Impact on Governance

Another significant benefit of internal control systems is their impact on corporate governance. Effective internal controls ensure that management and governance bodies are held accountable for their actions, promoting transparency and ethical behavior. Research by Lopez and Garcia (2023) highlighted the role of internal controls in strengthening governance practices by providing mechanisms for monitoring and oversight. This, in turn, reduces the risk of management override and ensures that organizational objectives are achieved in a responsible and ethical manner (Lopez & Garcia, 2023, p. 12)

2. Types of Internal Control Procedures and Practical Applications

Internal control procedures can be broadly categorized into preventive, detective, and corrective controls, each serving a unique purpose in safeguarding organizational assets and ensuring operational efficiency. Preventive controls are designed to deter errors or irregularities before they occur. For instance, segregation of duties is a widely used preventive control that ensures no single employee has control over all critical aspects of a financial transaction. This minimizes the risk of fraud and ensures accountability within the organization (Williams & Adams, 2023, p. 17)

Detective controls, on the other hand, identify discrepancies and errors after they have occurred. Common examples include bank reconciliations and internal audits. A study by Anderson and Kim (2022) revealed that companies that conduct regular internal audits are more likely to detect financial irregularities early, thereby reducing the risk of financial misstatements and regulatory penalties **(Anderson & Kim, 2022, p. 29)**

Corrective controls are implemented to address deficiencies in the internal control system and prevent them from recurring. These controls often involve revising policies, retraining staff, or implementing new technological solutions. For example, a company may implement a new automated system to enhance accuracy in financial reporting after identifying manual errors in its previous processes. According to Brown and Garcia (2021), organizations that adopt corrective measures in a timely manner experience fewer control-related failures and improved compliance with regulatory standards **(Brown & Garcia, 2021, p. 34)** One practical application of internal control procedures is in the procurement process. Effective controls in procurement ensure that purchases are authorized, adequately documented, and accurately recorded. Smith and Lee (2022) found that organizations with robust procurement controls experienced fewer instances of unauthorized purchases and budget overruns **(Smith & Lee, 2022, p. 41)**

Another area where internal controls are critical is in payroll management. Payroll controls, such as requiring dual approvals for salary adjustments and conducting periodic payroll audits, help organizations prevent salary fraud and ensure accurate compensation records. A study by Thompson et al. (2023) indicated that payroll control weaknesses are one of the most common sources of fraud in organizations, emphasizing the need for strong controls in this area **(Thompson & Zhao, 2023, p. 53)**

Finally, monitoring controls play a vital role in ensuring that other controls remain effective over time. Continuous monitoring includes activities such as performance reviews, variance analysis, and risk assessments. According to Johnson and White (2023), organizations that conduct regular monitoring activities are more likely to maintain effective internal controls and adapt to emerging risks **(Johnson & White, 2023, p. 60)**

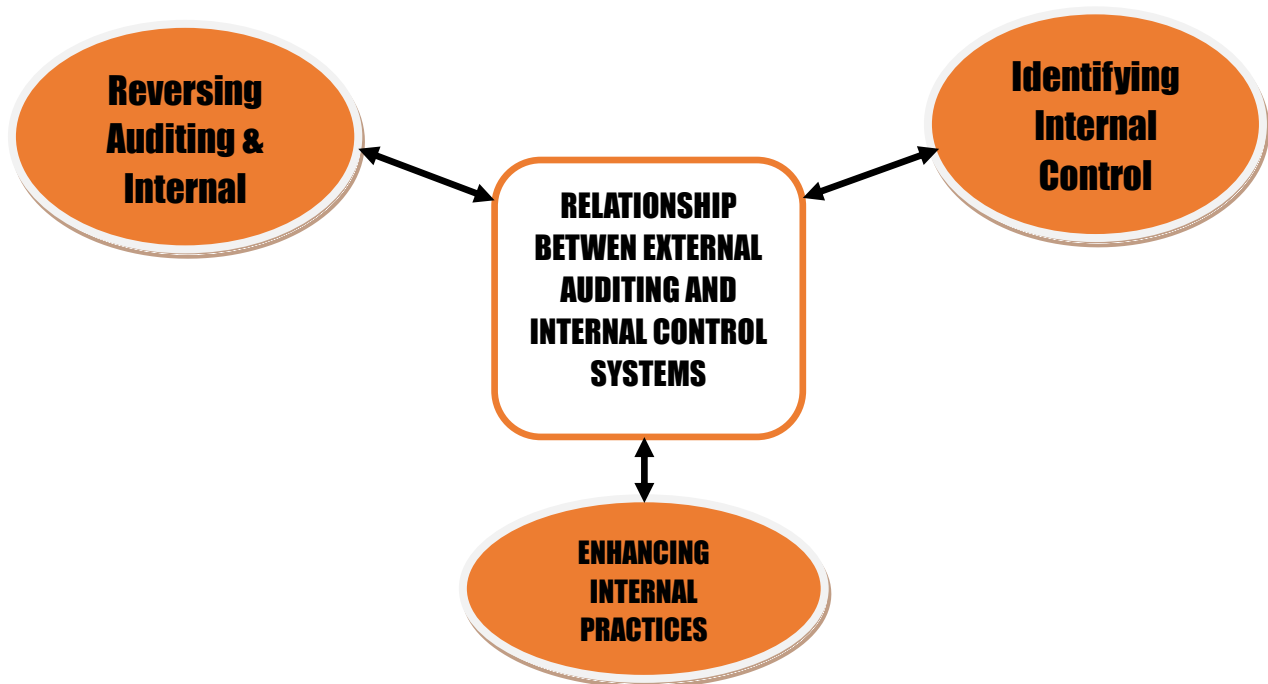
In summary, internal control procedures are essential for reducing risks, preventing fraud, and ensuring operational efficiency. By implementing preventive, detective, and corrective controls across various organizational processes, companies can enhance their overall control environment and achieve long-term stability. The effectiveness of these controls relies heavily on

continuous monitoring and adaptation to evolving risks and business environments.

III. Relationship Between External Auditing and Internal Control Systems

The relationship between external auditing and internal control systems plays a fundamental role in promoting transparency and accountability within organizations. External auditors evaluate the effectiveness of internal control systems to ensure that financial reports are free from material misstatements and that risks are properly managed. Recent studies highlight that internal controls serve as a first line of defense against financial irregularities, and auditors build upon this foundation to conduct more targeted and efficient audits (Johnston & Zhang, 2021, p. 34)

Figure 2 : Relationship Between External Auditing and Internal Control Systems



Source : Compiled by the researcher with the assistance of various sources.

1. The Relationship in Reducing Fraud

Research shows that organizations with robust internal control systems tend to have fewer financial reporting errors, which enhances stakeholders' trust in the company. For instance, Smith and Brown (2020) found that companies with weak internal controls were more likely to experience audit delays and adverse audit opinions. External auditors help mitigate such risks by identifying deficiencies in the internal control system and providing recommendations to improve them. This process not only strengthens the control environment but also reduces the likelihood of fraud and financial mismanagement (Smith & Brown, 2020, p. 45)

2. The Relationship in Identifying Internal Control

Moreover, external auditors rely on internal controls to determine the scope of their audit procedures. A study by Lopez and Gonzalez (2019) argues that auditors adjust their testing based on the effectiveness of internal controls. If controls are deemed strong, auditors can reduce the extent of their substantive testing, thereby increasing the efficiency of the audit process. However, when significant deficiencies are identified, auditors must expand their testing to ensure that all material risks are addressed (Lopez & Gonzalez, 2019)

3. The Relationship in Enhancing Governance Practices

The interaction between external auditing and internal controls also extends to corporate governance. According to recent research, auditors' insights on control weaknesses are highly valued by audit committees, as they provide actionable feedback to improve governance practices. Jones and Miller (2022) emphasize that the communication between external auditors and management is a critical element in fostering a culture of continuous improvement in internal controls (Jones & Miller, 2022, p. 58)

IV. The evaluation of the internal control system by the external auditor.

The external auditor's evaluation of the internal control system is an integral part of the audit process, as it helps ensure the reliability and integrity of financial statements. Internal controls encompass the policies, procedures, and practices that organizations implement to safeguard assets, ensure accurate financial reporting, and comply with relevant laws and regulations. For external auditors, evaluating internal controls is not merely a technical exercise, but a critical step in assessing the risk of material misstatement in financial reports and tailoring the audit approach accordingly. The International Standards on Auditing (ISA 315) outline that auditors must gain an understanding of the entity's internal control system to assess risks of material misstatement, whether due to fraud or error, and to design appropriate audit procedures.

1. Evaluation of internal control components

The auditor's understanding of the internal control system involves evaluating various components, such as the control environment, risk assessment procedures, control activities, information and communication systems, and monitoring processes. The control environment is the foundation of the internal control system and includes the organizational structure, culture, ethical values, and management's commitment to internal control. Risk assessment procedures help auditors identify potential risks that could affect financial reporting, and control activities refer to the specific actions taken to mitigate these risks. Information and communication systems ensure that

relevant financial data is communicated and used effectively, while monitoring processes involve ongoing assessments of the internal control system's effectiveness. By understanding and evaluating these components, auditors can identify control weaknesses and assess the likelihood of material misstatement, which in turn informs their audit strategy.

A key aspect of the auditor's evaluation is testing the effectiveness of the internal controls in practice. Auditors perform tests of controls to verify that they are operating as intended and to evaluate whether they are sufficient to prevent or detect material misstatements. This can involve a variety of procedures, such as walkthroughs, inquiries, observations, and testing specific control activities. For example, auditors may test whether the segregation of duties is adequate to prevent fraud, or whether the procedures for approving financial transactions are being followed correctly. If auditors find that controls are not operating effectively, they will adjust their audit approach by increasing substantive testing to ensure the accuracy of financial statements. As noted by Arens et al. (2019), effective internal controls significantly reduce the risk of errors or fraud, which in turn enhances the reliability of financial reporting (Arens and al, 2019, pp. 123-125)

2. Evaluation of the internal control System to Resuce Risks

The evaluation of internal controls has broader implications for corporate governance and risk management. By identifying weaknesses in the internal control system, external auditors provide management with valuable feedback, which can lead to improvements in organizational efficiency, compliance, and financial reporting practices. For example, research by Mautz and Sharaf (1961) emphasized the importance of an internal control system in minimizing the risk of financial misstatements and fraud, thus helping ensure the credibility of financial reports (Mautz & Sharaf, 1961, pp. 56-59). Furthermore, auditors may recommend improvements to the internal control framework, such as the enhancement of monitoring processes or the strengthening of segregation of duties, to better mitigate risks.

Several studies underscore the importance of the external auditor's role in evaluating internal controls. For instance, a study by Glover and Prawitt (2012) found that strong internal controls positively impact the quality of financial reporting and reduce the likelihood of financial misstatements (Glover & Prawitt, 2012, pp. 88-90). Similarly, the research by Choi et al. (2016) highlights how auditors' assessments of internal control can serve as an early warning system for management, alerting them to potential weaknesses before they result in significant financial reporting issues (Choi & Lee, 2016, pp. 145-150)

3. Evaluation of the internal control System To Enhance Stakeholder Confidence

Moreover, the evaluation of internal controls by external auditors is vital not only for regulatory compliance but also for enhancing stakeholders' confidence in the organization. In the context of corporate governance, internal controls are crucial for ensuring transparency and accountability, especially for publicly listed companies that face scrutiny from investors, regulators, and the public. In the absence of effective internal controls, organizations may face financial fraud, inaccurate financial reporting, and legal consequences, all of which can damage their reputation and financial standing. Consequently, auditors' evaluations are essential in safeguarding the interests of shareholders, creditors, and other stakeholders.

V.Evaluating Internal Control Systems by External Auditors: Methods and Approaches

Evaluating an organization's internal control system is a fundamental task for external auditors, as it plays a crucial role in ensuring the accuracy of financial reporting and safeguarding the company's assets. The effectiveness of these controls is key to detecting and preventing material misstatements, errors, or fraud. External auditors use a variety of methods to assess internal controls, each contributing to a comprehensive understanding of the control environment. These methods include understanding the design and implementation of controls, testing their operation, using sampling techniques, employing checklists, and utilizing modern technologies like data analytics.

Figure 3 : Evaluating Internal Control Systems

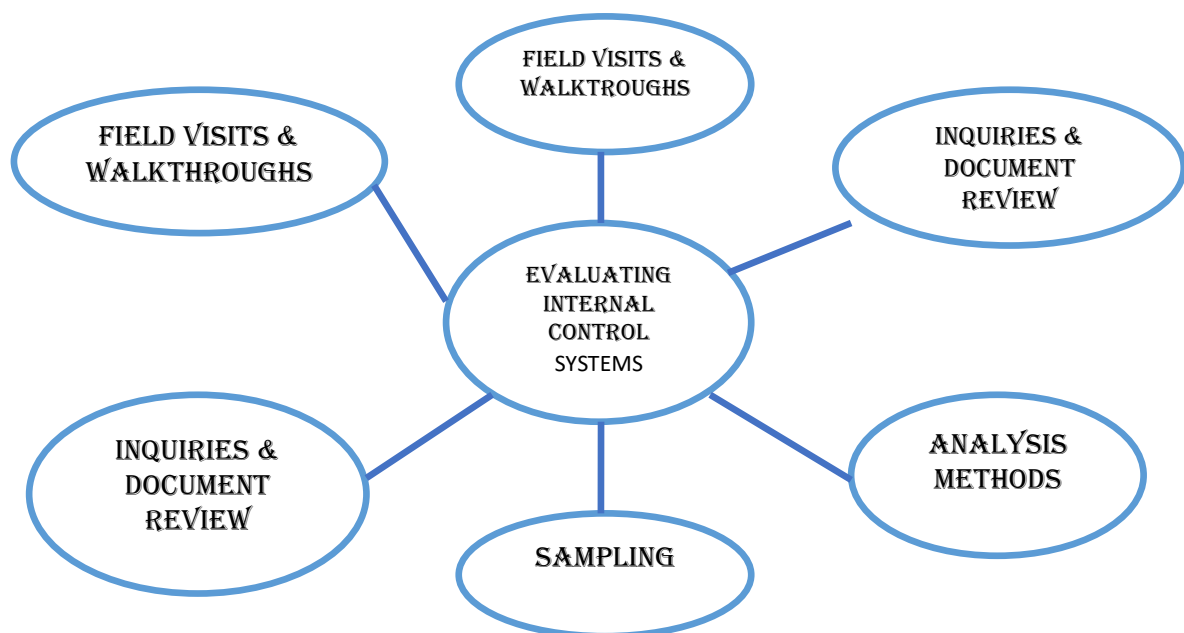


Figure 2 : Compiled by the researcher with the assistance of various sources.

1. Examination and Inspection Through Field Visits

One of the primary methods used by external auditors to evaluate internal controls is through understanding the design and implementation of the control environment. This process begins with a risk assessment, where auditors examine the control environment, including the company's organizational culture, ethical values, and management's commitment to strong financial reporting practices. Walkthroughs are commonly conducted to trace a transaction through the organization's processes. This helps auditors observe how the controls are implemented in practice and whether they align with the company's policies. Walkthroughs provide real-time evidence of how well controls are functioning and are essential for identifying areas that may require further attention (Messier & Prawitt, 2018, p. 234)

2. Inquiries and Examination of Financial Documents

Testing the effectiveness of internal controls is another important method for auditors. In this process, auditors perform various procedures to verify that controls are functioning as intended. This testing includes direct observation, inquiries with staff, and the inspection of financial documents. For instance, auditors may examine whether the segregation of duties is being followed, which is a critical control to prevent fraud. If auditors find that the controls are effective, they may rely on them, reducing the need for additional substantive testing. However, if weaknesses are identified, the auditor may expand the scope of testing to ensure that financial statements are accurate and free from misstatements (Whittington & Pany, 2018, p. 178)

3. Sampling Methods and Their Auditing

Sampling techniques are often used to evaluate the internal control system, especially in larger organizations where it is impractical to test every transaction. Auditors select a sample of transactions and review them to assess whether the internal controls were applied consistently. These sampling methods can be either statistical or non-statistical, depending on the auditor's goals and the characteristics of the control environment. Statistical sampling can help auditors draw conclusions about the effectiveness of controls based on the reviewed sample, while non-statistical sampling allows for more flexibility in testing (Pincus & Roussey, 2014, p. 102)

4. Methods of Questionnaires and Audit Listings

Control questionnaires and checklists provide another method for auditors to evaluate the internal control system systematically. These tools help auditors assess whether the company's internal controls cover all necessary areas and function as intended. By focusing on high-risk areas, auditors can identify weaknesses that may require further investigation or corrective action. In

addition, interviews with key personnel offer valuable insights into the day-to-day application of controls and whether there are any challenges in their implementation (Tysiac, 2019, p. 112)

5. Data analysis methods

With advancements in technology, auditors now increasingly rely on data analytics to evaluate internal controls. Data analytics tools enable auditors to analyze large volumes of financial transactions quickly and efficiently, identifying patterns, anomalies, or irregularities that could indicate control failures or potential fraud. These tools are particularly useful in organizations with complex financial systems or when dealing with vast amounts of transactional data. The use of data analytics provides auditors with a more comprehensive view of the company's internal controls and can improve the efficiency and accuracy of their evaluations (Vasarhelyi and al, 2017, p. 67)

VI. Concepts of Performance and Financial Performance

1. Defining Performance: A Comprehensive Understanding

Performance is a multifaceted concept that can be defined in various ways depending on the context in which it is used. In general, performance refers to the achievement of objectives or goals within a specified period. In the business and organizational context, performance often refers to how well an organization, team, or individual meets the established targets, such as financial goals, productivity levels, or quality standards. According to Kaplan and Norton (1992), performance in a business setting is commonly evaluated by assessing the outcomes against predefined benchmarks or key performance indicators (KPIs), which are used to measure the efficiency and effectiveness of actions taken (Kaplan & Norton, 1992, p. 71)

Furthermore, performance is influenced by both individual and contextual factors. Personal attributes, such as motivation, skill level, and experience, can significantly affect an individual's performance, as noted by Judge et al. (2001), who highlight the role of personality traits in predicting job performance (Judge and al, 2001, p. 410) Contextual factors, such as organizational culture, leadership, and resource availability, also play crucial roles in shaping performance outcomes. For instance, supportive leadership and a positive organizational culture can enhance employee motivation, which in turn boosts performance levels (Bass, 1999, p. 47)

2. Defining Financial Performance: A Comprehensive Overview

Financial performance is a critical measure of an organization's financial health and its ability to achieve its economic goals over a specific period. It reflects how well an organization manages its resources to generate profits,

maintain liquidity, and sustain long-term growth. Financial performance is typically evaluated through financial statements, including the income statement, balance sheet, and cash flow statement, which provide insights into the company's profitability, solvency, and operational efficiency. According to Brigham and Houston (2021), financial performance involves assessing key indicators such as revenue growth, return on assets (ROA), return on equity (ROE), and profit margins, which collectively indicate whether the organization is meeting its financial objectives (**Brigham & Houston, 2021, p. 133**)

At its core, financial performance reflects an organization's ability to create value for its shareholders. This value creation can be measured by analyzing both profitability ratios and efficiency ratios. Profitability ratios, such as gross profit margin and net profit margin, provide a snapshot of the company's ability to generate earnings from its operations. Meanwhile, efficiency ratios, such as asset turnover and inventory turnover, measure how effectively the organization utilizes its assets to produce revenue (**Gitman and al, 2022, p. 198**).

These indicators offer a comprehensive view of the company's financial performance and highlight areas for potential improvement.

Financial performance is influenced by both internal and external factors. Internal factors include the company's management practices, financial policies, and operational strategies. For instance, an effective cost management strategy can improve profit margins, while strong cash flow management ensures the organization remains solvent. On the other hand, external factors such as economic conditions, market competition, and regulatory changes can impact financial performance. For example, during periods of economic uncertainty, companies may face declining revenues and increased costs, which negatively affect their financial outcomes (**Ross and al, 2021, p. 54**)

A holistic assessment of financial performance also considers both short-term and long-term financial outcomes. Short-term performance focuses on immediate financial results, such as quarterly earnings and liquidity ratios, while long-term performance looks at sustainability, growth potential, and shareholder value creation. According to Subramanyam (2020), long-term financial performance is more significant for stakeholders, as it indicates the company's ability to sustain profitability and remain competitive in the market over time (**Subramanyam, 2020, p. 309**)

3. The Relationship Between Financial Performance and Internal Control Systems

The link between financial performance and internal control systems is essential for any organization aiming to achieve long-term success. Internal controls serve as a framework to safeguard an organization's assets, ensure

accurate financial reporting, and enhance operational efficiency. When these systems are well-designed and effectively implemented, they directly contribute to improving financial performance. Simply put, companies with strong internal controls are better at managing risks, reducing losses, and avoiding financial errors or fraud, all of which lead to healthier financial results (**Harrison & Horngren, 2021, p. 102**).

The relationship works both ways. Good financial performance also supports the improvement of internal controls. Companies that are financially stable have more resources to invest in advanced control mechanisms, such as automated financial systems or regular audits. In contrast, companies facing financial difficulties may neglect internal controls, making them more vulnerable to risks. It's a cycle: strong controls improve performance, and better performance allows companies to strengthen their controls even further (**Kaplan & Atkinson, 2020, p. 78**).

Another way internal controls impact financial performance is by creating a culture of accountability. When employees know that financial processes are monitored and controlled, they are less likely to engage in unethical behavior or take financial risks. This sense of responsibility can reduce fraud and financial misconduct, which are major threats to financial performance. Moreover, organizations that promote transparency and accountability through their internal controls are more likely to attract investors and maintain trust with stakeholders, which positively affects their financial standing (**Subramanyam S. , 2021, p. 190**).

However, it's important to recognize that too many controls can also slow down financial performance. Overly rigid controls might create bureaucracy and reduce operational efficiency. Therefore, organizations must strike a balance. They need to focus on risk-based internal controls that protect key financial areas without adding unnecessary complexity. This balance allows companies to achieve strong financial performance without sacrificing flexibility and innovation (**Atrill & McLaney, 2022, p. 211**).

In summary, the relationship between financial performance and internal control systems is a continuous loop of improvement. Strong internal controls lead to better financial outcomes, and healthy financial performance allows organizations to invest in even stronger controls. Companies that understand this connection and actively manage their internal controls are more likely to achieve long-term success, maintain stakeholder trust, and navigate financial risks with confidence.

VII. Applied study

To shed light on the internal control system within Algerian economic institutions and to understand its impact on improving financial performance, we conducted an applied study at a printing company. This study aims to highlight the role of the external auditor in evaluating the institution's internal control system, given the importance of this system in any organization. The more accurate and effective the internal control system is, the better it protects the company's assets from fraud and manipulation. Accordingly, we will present a report on internal control procedures, which has been prepared by the external auditor during the course of the assigned audit mission.

1. Presentation of Internal Control Evaluation Report

As part of the annual financial audit mission, the external auditor conducted an examination of the accounting procedures and the internal control system to safeguard the company's assets and ensure the accuracy and reliability of the annual financial statements.

At the end of the fiscal year, the internal control procedures were in the process of being updated to align with the new financial accounting system. However, certain shortcomings related to old practices remain persistent.

1.1 Key Points Addressed in the Report:

1.1.1 Fixed Assets :

The department responsible for managing fixed assets does not maintain an updated register of these assets. It is necessary to create and regularly update a comprehensive database of fixed assets to ensure accurate tracking and efficient management.

1.1.2 Customers :

- **Customer Relationship Procedures:** Customer handling processes are still under development, with the absence of formal and clear procedures.
- **Inaccurate Debt Follow-up:** There is a lack of regular reminders to customers regarding outstanding debts, resulting in the accumulation of overdue payments without effective collection procedures.
- **Unconfirmed Customer Balances:** Not all customer balances have been directly confirmed with the concerned parties, leaving room for errors or inaccurate amounts.
- **Incomplete Implementation of Articles 09 and 10:** There is a lack of strict enforcement of payment terms and late payment penalties for customers who delay their payments.
- **Aging Analysis of Debts:** The analysis of overdue debts was halted as of 12/31/N, and the final results are still being prepared.

Following these recommendations will contribute to improving internal control and enhancing the accuracy and transparency of financial reports.

- **Handling Non-Compliant Customers :**

- Customers who do not adhere to payment deadlines are not regularly reminded, leading to a buildup of debts without effective collection actions.
- Current debts for the year N and a portion of old debts were settled with only 34 customers, while the debts of some customers have increased significantly without any actions taken against them.

- **Inactive Customers :**

There are customers who have ceased operations but belong to other active entities. Special treatment should be given to outstanding debts related to these customers to ensure faster recovery.

- **Challenges in Enforcing Legal Judgments:**

Problems arise in executing judgments due to lawsuits being filed under the commercial name of clients instead of their legal entity names, which hinders legal collection procedures. (Observations from N-1)

- **Purchase Orders and Invoice Preparation:**

Purchase orders were not an essential part of the invoice preparation process until the beginning of the year N, despite previous recommendations made a year earlier.

- **Lack of Periodic Reports from the Technical Department:**

The technical department does not prepare periodic reports that verify the commercial department's data regarding output quantities and waste, leading to a lack of precise follow-up.

- **Provisions for Doubtful Debts:**

Provisions should be established based on specific internal procedures that include criteria taking into account the nature of the customer and their financial status. This process should be supervised by a designated commercial committee responsible for decisions on outstanding debts.

1.1.3 Recommendations :

- **Coordination Between Departments:**

- Establish procedures to ensure consistency of information related to newspaper withdrawals and waste quantities between the technical, commercial, and accounting departments.

- **Defining Responsibilities:**

- Develop job description cards for each position, clearly defining the tasks and responsibilities of each employee to enhance work efficiency and clarity.
- **Document Approval and Accountability:**
 - Ensure that documents issued by the technical department are authorized and signed by an approved official before being sent to other departments to guarantee accuracy and accountability.
- **Periodic Reports:**
 - Prepare regular reports on technical activities to enhance transparency and monitoring.
- **Customer Contract Compliance:**
 - Establish procedures to verify compliance with customer contracts and incoming orders through coordination between the commercial and technical departments.
- **Delivery Documentation:**
 - Require the technical manager to sign delivery documents to avoid customer disputes regarding delivered quantities and reduce the need to issue correction invoices.
 - Provide a receipt document confirming that the customer has received the delivered quantities from the company to ensure proper documentation.
- **Debt Collection Reminders:**
 - Implement a system or program to remind customers of outstanding debts to avoid aging debts and protect the company from potential disputes.
- **Regular Debt Collection Reports:**
 - Ensure that debt collection reports are issued periodically and regularly by the commercial department to maintain accurate information. This has been activated during N+1.
- **Software Development:**
 - Upgrade the software used to provide updated information on customer status immediately, as the current system in year N does not allow for regular debt tracking and relies on external sources.

1.1.4 Treasury :

- **Cash Management:**

The accounting department must retain all cash documents and keep them organized in a dedicated area within the accounting office. This will help:

- Keep accounting records up to date.
- Verify monthly balances.

- Conduct surprise checks on actual balances to ensure they match the records.

1.1.5 Organization :

- **Job Descriptions :**

It is recommended to develop job description cards for each position to clearly define tasks and responsibilities, thereby improving work efficiency and task clarity.

- **Mutual Control Procedures:**

Introduce mutual control procedures, including:

- Payroll verification during preparation.
- Vacation calculation and auditing.
- Reviewing salary and allowance calculation standards.

- **Annual Leave Management:**

The accounting department should:

- Record vacations in advance within the accounts.
- Monitor unused vacation days within the specified timeframe and record them as accrued vacation wages, with individual follow-ups for each employee by name.
- Avoid including them as debt provisions as long as they are known and their value is calculated.
- **Tax Declarations Review:**
- Submit all tax and semi-tax declarations to the general manager and financial manager for review and approval before submission, especially those that may impact financial results.
- Avoid preparing monthly declarations (G50) outside the accounting system to prevent discrepancies between accounting records and tax declarations.

2. Analysis of the Report and Results

The report findings indicate that the absence of an updated register for fixed assets negatively impacts asset management efficiency and overall organizational performance. Establishing and maintaining a comprehensive database of fixed assets is essential for ensuring accurate tracking and effective management.

Regarding customer account management, significant challenges were identified in receivables collection, directly affecting the company's financial performance. The lack of regular reminders for customers and ineffective collection procedures have extended the collection cycle and increased the risk of non-recovery, posing a substantial financial threat to liquidity and operational

profitability. Implementing the external auditor's recommendations will enhance both financial and administrative efficiency, strengthening the company's ability to address future financial challenges.

Invoicing procedures were also found to be inefficient, as the absence of purchase orders in the billing process has weakened financial control and oversight. This has led to undocumented transactions and increased the risk of financial errors. Additionally, the lack of periodic reports has limited the ability to verify the accuracy of quantities recorded by the commercial department, potentially resulting in incorrect inventory valuation and misstatement of revenues or losses. Strengthening operational efficiency through better departmental coordination will improve financial transparency and ensure that all financial transactions are properly documented.

Enhancing coordination between departments and ensuring data consistency reduces errors caused by information discrepancies, thereby improving the accuracy of financial reports. It also increases operational efficiency by minimizing redundant efforts and conflicting information, leading to cost savings and better organizational performance. Improved coordination enables faster and more effective decision-making.

In treasury management, strengthening cash book controls and organizing financial records within the accounting department will not only improve financial performance but also enhance operational efficiency. This includes better time management, error reduction, and improved internal oversight, ultimately expediting financial transactions and increasing overall financial and administrative performance.

The implementation of these organizational improvements will contribute to higher administrative efficiency, reduced accounting errors, and stronger internal controls, ultimately leading to improved financial performance, enhanced transparency, and greater accountability within the organization.

VIII. Conclusion

The evaluation of internal control systems by external auditors plays a crucial role in enhancing financial performance. By identifying weaknesses, detecting errors, and mitigating risks such as fraud, auditors help organizations strengthen their control environment. This leads to more accurate financial reporting, improved operational efficiency, and greater transparency.

As demonstrated in the applied study, the auditor's recommendations contributed to improving cash flow management, enhancing accountability, and ensuring regulatory compliance. Strong internal controls not only protect organizational assets but also build stakeholder confidence, fostering long-term financial stability and sustainable growth.

IX. Recommendations

To enhance financial performance and compliance, organizations should:

1. **Strengthen Internal Controls:** Regularly update policies and procedures to address risks, minimize errors, and prevent financial misstatements. For example, implementing automated debt collection reminders can improve cash flow management.
2. **Implement Auditor Recommendations:** Ensure that audit findings are promptly addressed to enhance transparency and operational efficiency, such as enforcing stricter purchase order verification processes.
3. **Enhance Staff Training:** Provide continuous training in finance and accounting to improve awareness and application of internal controls.
4. **Monitor Implementation of Controls:** Establish a follow-up mechanism to track progress on audit recommendations, ensuring consistent compliance.
5. **Integrate Risk Management Strategies:** Adopt proactive risk assessment frameworks to strengthen financial stability and build investor confidence.

By applying these measures, organizations can improve financial performance, enhance governance, and ensure long-term growth.

X. Bibliography List

1. Books

- Atrill P, & McLaney. E. (2022). Management Accounting for Decision Makers (11th ed). Pearson Education
- Arens. A. A, Elder R. J, & Beasley. M. S. (2019). Auditing and Assurance Services: An Integrated Approach (16th ed). Pearson Education.
- Brigham, E. F. & Houston, J. F. (2021). Fundamentals of Financial Management (15th ed). Cengage Learning
- Harrison, W. T., & Horngren, C. T. (2021). Financial Accounting: Global Edition (11th ed.). Pearson Education, p. 102.
- Kaplan, R. S, & Atkinson A. A. (2020). Advanced Management Accounting (4th ed.). Pearson Education, p. 78.
- Lawrence J. Gitman & Chad J. Zutter. (2022). Principles of Managerial Finance (16th ed). Pearson Education
- Messier, W. F., Glover, S. M., & Prawitt, D. F. (2018). Auditing and Assurance Services: A Systematic Approach (9th ed.). McGraw-Hill Education, p. 234
- Ross, S. A., Westerfield, R. W., & Jaffe, J. F. (2021). Corporate Finance (éd. 13th ed). McGraw-Hill Education.p.54
- Subramanyam K. R . (2021). Financial Statement Analysis (12th ed). McGraw-Hill Education.

2. Journal articles:

- Afshan. Y & Aza .A. (2019). Essentiality of internal control in Audit process. International Journal of Business and Applied Social Science , 5 (11).
- Afshan.Y & Rengarajan.V. (2024). Exploratory Study on the Importance of Internal Control in Auditing. International Journal Of Academic Research In Business And Social Sciences , 14 (6).
- Ait Novatiani, R. Wedi R , & Andry A . (2024). Internal auditor competence and internal control: Improving internal audit quality to prevent fraudulent financial statements. Cogent Business & Manageent , 11 (1), 2-17.

- Alex A , Takyi. K , & Ebenezer Y. (2019). The Impact Of Auditing And Internal Controls On The Management Of A Business Organization. A Case Study Of Prudential Bank Limited (Weija Branch). EPRA International Journal of Research and Development , 4 (12).
- Ali Kadhim. (2018). The Role Of Internal Auditing And Internal Control System On The Financial Performance Quality In Banking Sector. Biblioteca Digital Repositorio Académico , 34 (86), 3046-3054.
- Anderson. M, & Kim J. (2022). The Role of Internal Audits in Financial Risk Management. Journal of Financial Control , 15 (3), 25-38.
- Bass. (1999). Transformational Leadership: Industrial, Military, and Educational Impact. Lawrence Erlbaum Associates,.
- Brown, T., & Garcia L. (2021). Corrective Measures in Internal Control Systems. International Review of Business Controls , 12 (2), 30-45.
- Carter, L., & Silva, R. (2020). Improving Financial Reporting Through Internal Controls. Accounting and Finance Review , 14 (1), 25-30.
- Choi, J. H., Kim, S., & Lee, J. (2016). Internal Control and Audit Quality: Evidence from Korea. Journal of Accounting and Public Policy , 35 (2), 142-163.
- Glover, S. M., & Prawitt, D. F. (2012). Auditing and Assurance Services. Pearson Education, pp. 88-90.
- Johnson, P., & Nguyen, T. (2021). Fraud Prevention Through Internal Controls. Journal of Financial Integrity , 27 (2), 38-42.
- Johnson, P., & White, K. (2023). Continuous Monitoring for Effective Internal Controls. Corporate Governance Journal , 18 (1), 50-65.
- Johnston R, & Zhang L . (2021). The Impact of Internal Controls on Audit Quality. Journal of Accounting Research , 59 (1), 32-50.
- Jones, T., & Miller, S. (2022). Corporate Governance and External Auditors: Strengthening Internal Control Systems . Contemporary Accounting Perspectives , 14 (4), 55-70.
- Timothy A. Judge , Carl.J , Joyc E Gregory K. (2001). The Job Satisfaction-Job Performance Relationship: A Qualitative and Quantitative Review. Psychological Bulletin , 127 (3), 376-407.
- Kaplan, R. S., & Norton, D. P. (1992). The Balanced Scorecard: Measures That Drive Performance. Harvard Business Review, p. 71
- Kim, H., & Lee, S. (2020). Building Accountability Through Internal Control Systems. Corporate Governance Review , 12 (1), 35-38.
- Kim J, & Park S. (2022). Internal Controls and Organizational Performance. Management Perspectives Journal , 16 (2), 50-55.
- Lopez .P & Garcia. (2023). Relationship Between Internal Control And Treasury Management In A Peruvian Municipality. Journal Of Law And Sustainable Development , 11 (2), 10-17.
- Lopez.P, & Gonzalez. (2019). Auditors' Reliance on Internal Controls: Implications for Audit Scope and Efficiency. International Journal of Auditing , 23 (2), 20-35.
- Martin, D., & Wallace, P. (2021). Preventive and Detective Internal Controls in Modern Organizations. Journal of Business and Management Studies , 18 (2).
- Mautz, R. K., & Sharaf, H. A. (1961). The Philosophy of Auditing. American Accounting Association, pp. 56-59.
- Pincus, K. V., & Roussey, M. M. (2014). Internal Control: A Manager's Journey to Excellence. Wiley, p. 102.
- Smith J, & Brown K. (2020). Internal Control Deficiencies and Audit Outcomes: A Meta-Analysis, 39(3), 42-65. Auditing: A Journal of Practice & Theory , 39 (3).
- Smith R , & Jones M. (2022). Expanding the Scope of Internal Controls: Beyond Financial Reporting. Global Compliance Journal , 30 (3), 48-55.
- Smith R , & Lee S. (2022). Procurement Controls: Best Practices for Fraud Prevention. Procurement and Operations Review , 14 (4), 39-52.

***Evaluation Of The Internal Control System By The External Auditor And Its Impact
On The Financial Performance Of The Organization : An Applied Study***

- Thompson D, & Evans M. (2019). Risk Management and Internal Control Systems. *Journal of Business Risk* , 11 (3), 17-23.
- Thompson J , Evans C, & Zhao L. (2023). Payroll Controls: Addressing Fraud and Compliance Risks. *Accounting and Auditing Perspectives* , 19 (2), 45-58.
- Tysiac, K. (2019). Auditor's Evaluation of Internal Controls in the Modern Era. *Journal of Accountancy* , 228 (6), 110-115.
- Vasarhelyi, M. A., Alles, M. G., & Williams, P. F. (2017). The Audit Data Revolution: Implications for Audit Practice and Regulation. *Accounting Horizons*, 31(3), 63-74, p. 67.
- Whittington O. R , & Pany K. (2018). *Principles of Auditing and Other Assurance Services* (éd. 20th ed). McGraw-Hill Education.
- Williams. D , & Adams H . (2023). Preventive Controls in Modern Organizations. *Journal of Risk and Control* , 20 (3), 10-25.