T.C

BİNGÖL UNIVERSITY

GRADUATE SCHOOL OF SOCIAL SCIENCE

BUSINESS ADMINISTRATION DEPARTMENT

THE ROLE OF CORPORATE GOVERNANCE IN CONTROLLING FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN ERBIL-IRAQ

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Master's Thesis

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BİNGÖL -2017

T.C.
BİNGÖL ÜNİVERSİTESİ
SOSYAL BİLİMLER ENSTİTÜSÜ
İŞLETME ANABİLİM DALI

ERBİLDEKİ (IRAK) TİCARİ BANKALARIN FİNANSAL PERFORMANSININ DENETİMİNDE KURUMSAL YÖNETİMİN ROLÜ

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BİNGÖL – 2017

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BİLİMSEL ETİK BİLDİRİMİ

Yüksek Lisans tezi olarak hazırladığım [ERBİLDEKİ (IRAK) TİCARİ BANKALARIN FİNANSAL PERFORMANSININ DENETMİNDE KURUMSAL YÖNETİMİN ROLÜ] adlı çalışmanın öneri aşamasından sonuçlanmasına kadar geçen süreçte bilimsel etiğe ve akademik kurallara özenle uyduğumu, tez içindeki tüm bilgileri bilimsel ahlak ve gelenek çerçevesinde elde ettiğimi, tez yazım kurallarına uygun olarak hazırladığım bu çalışmamda doğrudan veya dolaylı olarak yaptığım her alıntıya kaynak gösterdiğimi ve yararlandığım eserlerin kaynakçada gösterilenlerden oluştuğunu beyan ederim.

29 /05/ 2017

İmza

Twana Ali HASAN

THESİS ACCEPTANCE AND APPROVAL

This thesis entitled "**The Role Of Corporate Governance In Controlling Financial Performance Of Commercial Banks In Erbil-Iraq**" presented by Twana Ali HASSAN under the supervision of Prof. Dr. Muammer ERDOĞAN in the business administration department has been accepted as a Master Thesis according to the rules of Higher Education Intuition of Republic of Turkey on / /2017 with unanimity of the member of jury.

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This thesis has been approved by the committee of the institute of science on …/..../…... with decision number ..../.........

Signature

Prof. Dr.

Director of Institution

ÖNSÖZ

Bu çalışmanın yürütülmesi için yardımlarını esirgemeyenlere en içten dileklerim ile teşekkür ederim.

Özelliklede bu tez çalışmamda danışmanlığımı yapan değerli hocam Profesör Dr. Muammer ERDOĞAN Bey'e minnettar olduğumu ve bana fikir vererek ve onun sayesinde bu tezi başarıyla tamamlamakta olduğumu ifade etmek isterim. Allah sizleri korusun.

Destekleri için sürekli benimle birlikte çalışan teşvikçi danışmanım Dr. Nasim Bey'e de samimi takdirimi sunuyorum.

ailemize cömert teşviklerinden ötürü teşekkür etmek istiyorum. Yrd. Dç.Wrya Burhan'a, Dr. Dler Musa'ya ve Yrd. Dç. Sami Sabir'e en içten dileklerimi sunarım.

29. 05. 2017

Twana Ali HASAN

ACKNOWLEDGEMENT

I most sincerely wish to express my gratitude to all people who in one way or another presented me the help of any kind when conducting this study.

I would like to express my profound gratitude to my study supervisor, Prof. Dr. Muammer ERDOĞAN for his intellectual guidance that he enabled me to work through the thesis and to complete this thesis successfully, God bless you.

My sincere appreciation is extended to senior lecturer Dr. Naseem Yousif Hanna for his continuous support, who worked with me as encouraging advisor.

I would like to thank all my family members for their generous encouragement and support. Further, I pass my warmest thanks to Assistant Prof. Wrya Burhan, Dr. Dler Musa and Assistant. Prof. Sami Sabir.

ÖZET

Bu çalışma Erbil'de, Irak, faaliyet gösteren ticari bankaların finansal performansının denetiminde, kurumsal yönetimin (yönetim kurulu, iç kontrol sistemi, dış denetim, şeffaflık ve açıklama, hesap verebilirlik ve muhasebe kontrolü ve denetim komiteleri) ilişkisinden ve etkisinden haberdar olmak yanında kurumsal yönetimin rolünü ortaya çıkarmaya kalkışmıştır.

Buna göre, tez araştırmada belirlenen metodoloji; bağımsız değişken olan kurumsal yönetim ile finansal performansı temsil eden bağımlı değişken arasındaki ilişkinin doğası ve etkisi üzerine yoğunlaşan birkaç soruyu inceleyerek, sorunun tespit edilmesidir. Bu nedenle, çalışma için tasarlanmış üç ana hipotez meydana çıktı. Sonra hipotezlerin kabul edilip edilmeyecekleri çeşitli istatistiksel testlere tabi tutuldu.

Sonuç olarak, çalışma analitik betimsel yöntem izledi. Ardından, tanımlayıcı istatistikler, değişkenlerin ve boyutların önemli özelliklerini, Erbil şehirindeki ticari nüfus çalışma popülasyonlarını ortalama, standart sapma ve t-testleri kullanarak nicel olarak tanımlamak için kullanıldı. (24) bankada temsil edilen ve ankete cevap veren kişilere (125) anket formu dağıttıktan sonra (119) geçerli form analize alındı. Sosyal Bilimciler için İstatistiksel Paket (SPSS V-22) kullanılarak ilişkinin büyüklüğünü ve finansal performans tahminini belirlemek için sırasıyla Spearman korelasyon katsayısı ve Çoklu Regresyon Analizi, uygulanmıştır.

Bulgular: Çalışma, bir takım sonuçlara ulaşmıştır; en önemlisi, çalışma, bağımsız değişkenler ile toplam ve kısmı düzeyler üzerindeki bağımlı değişken arasındaki etkiyi ve korelasyonu bulmuştur. Dolayısiyle, kurumsal yönetimin ticari bankaların istikrarında ve finansal performanslarının kontrolünde önemli bir rol oynadığı belirlenmiştir.

Anahtar sözcükler: Kurumsal Yönetim, Yönetim Kurulu, İç Kontrol Sistemi, Dış Denetim, Şeffaflık ve Bilgilendirme, Hesap Verebilirlik, Denetim Komiteleri ve Finansal Performans.

ABSTRACT

The present study tried to examine the role of corporate governance as (board of directors, internal control system, the external audit, transparency and disclosure, accountability and accounting control, and audit committees) in controlling financial performance, to know the relationship and effects of corporate governance in controlling financial performance of commercial banks operating in Erbil city, Iraq.

In the methodology of this research; identify the study's problem, through examining several questions, concentrated on the nature of the relationship and effect between independent variables and dependent variable that represents financial performance, and a conceptual scheme designed for the study, and then produced three main hypotheses, so to make sure that the hypotheses are accept or may not, they subjected to several statistical tests.

The descriptive analytical of the study show the important features of the variables and dimensions as well as the study population commercial banks in Erbil city, using mean, standard deviations, and t-tests. The findings from analyses show that (24) banks are contributed in this study, after distributing (125) questionnaire form on the respondents, (119) valid form were obtained for analysis. Statistical package for social scientists (SPSS V-22) was used and Spearman correlation coefficient and Multiple Regression Analysis to determine the magnitude of the relationship and prediction of financial performance respectively were applied

Results of the study reached to several findings, most notably the study found a correlation and effect between independent variables and dependent variable on the aggregate and partial levels. Hence, it was found that corporate governance play an important role on commercial banks stability and in controlling their financial performance.

Keywords: Corporate Governance, Board of Directors, Internal Control System, External Audit, Transparency and Disclosure, Accountability, Audit Committees and Financial Performance.

DEDICATION

I present my thesis and efforts to my beloved parents, whom they continuously encouraged and backed me during my life. I also present it to my brothers (Tanya, Kocher and Dana), as well as to my sister (Tara), and all my relatives and friends.

ABBREVIATIONS

Abbreviations	Explanation
CG	Corporate Governance
BOD	Board of Directors
ICS	Internal Control System
EA	External Audit
TAD	Transparency And Disclosure
AC	Audit Committees
AAC	Accountability And Accounting Control
FP	Financial Performance
DS	Descriptive Analysis
R	Correlation
R^2	R Square
MLRA	Multiple Linear Regression Analysis
F	ANOVA Test
DF	Degree of Freedom

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CHAPTER ONE
INTRODUCTION TO THE STUDY

1.1. Introduction

Corporate governance is reflected as one of the substantial topics for all local and international corporations, generally and commercial banks in particular. The financial crises that the world economy experienced from, made a corporate governance concept and urgency. Corporate governance rules, laws and systems in the world focus on decreasing use of the administrative power, away from the shareholders' interests and stimulate the performance of the board of directors in these firms. Additionally, they strengthen internal inaccuracy and chasing the implementation of the policies, as well as specifying the roles and terms of reference for each of the shareholders, board of director, executive board, and stakeholders to confirm the significance of transparency and disclosure. The concept of corporate governance is a curative path and new mechanism aimed at consolidating the integrity of the financial transactions via putting constraints that serve the public interests and private rights of the shareholders.

Accordingly, it is necessary to say that the crucial reasons that resulted in the collapse of many economic entities are a misapplication of the accounting principles, as well as a lack of disclosure and transparency. Moreover, not showing data and the true information that reveals the statement of affairs for these economic entities led to their collapse, too. This reflected on a number of repercussions, the most important of which was a loss of self-confidence concerning accounting information, consequently, this information lost its privilege, i.e. its quality.

Outstanding to this growing attention to the corporate governance, this study proposes to shed light on the role of the proper practice of governance in controlling the financial performance of commercial banks. This study also predicts the stability of these banks or their failure in the long run. The components of corporate governance became one of the common footings used in all corporations, especially commercial banks because these banks are built on trust which is reflected as one of the most vital pillars of governance.

Accordingly, the researcher studied the problems that corporate governance face in the commercial banks in Erbil city in Iraqi-Kurdistan region with regard to the administrative, financial, and regulatory aspects in order to improve its performance, increase investors' confidence, and strengthen banking industry.

This study pursues to examine the role of corporate governance in controlling financial performance of commercial banks. It is anticipated that the understanding gained from this study will lead to proper thoughtful of those elements responsive to corporate governance. The result of this study will contribute to commercial banks by identifying relevant corporate governance components and how these governance components affect financial performance. The result of this study contributes to the existing literature by providing evidence on the relation between corporate governance components and banks' financial performance.

In order to achieve the purpose of the study, it is organized into five chapters. Chapter one is the introduction, which includes of a problem statement, the significance of the study, the purpose of the study, conceptual scheme of the study, and the hypothesis of the study. Chapter two of the study reviews the literature relevant to the study topic as it addresses the corporate governance and financial performance.

In chapter three the methodology of the study is defined, as it describes the study design, the explanation of the study population, the sampling procedures, and data collection procedures, data collection instrument, data analysis and the limitation of the study. Then chapter four obtain findings of the data analysis. Finally, chapter five presented the conclusions of the findings, recommendations, practical implications, and suggestions for future studies.

1.2. Background of the Study

The Kurdistan Region of Iraq has experienced a good growth in the economy in the last decade in the majority of the different economic sectors, particularly in banking sector a lot of commercial banks started their investment in the region. As a result of this commercial banks growth, the need for corporate governance became crucial– that are capable of controlling the financial performance and contributing to the development of the economy. Therefore, the

need for improving the banking sector in general and the financial performance, in particular, has been the subject of the government, universities and researchers attentions. In the banking industry, corporate governance involves the way banking institutions' business and affairs are managed by the board of directors and the top management, which affects how the bank works out the bank's objectives, plans and policies, taking into consideration making appropriate economic returns for founders and other shareholders, day-to-day work management, protection of the rights and interests of recognized stakeholders (shareholders and depositors), companies' commitment to sound and safe professional behaviors and practices which are in conformity with regulations and legislations, (Linyiru, 2006:54). Recently there has been considerable interest in the corporate governance practices of modern corporations, particularly since the high-profile collapses of large U.S. firms such as Enron Corporation and WorldCom (Nambiro, 2007: 23).

These are factors which play a role in affecting the financial performance of a commercial bank. Most studies divide the determinants of commercial banks' financial performance into two categories, namely internal and external factors. Internal determinants of profitability, which are within the control of bank management, can be broadly classified into two categories, i.e. financial statement variables and nonfinancial statement variables, (Linyiru, 2006:67).

Accordingly, this study pursues to understand the role of corporate governance process of the commercial banks in Erbil Kurdistan and examine its effect in controlling the financial performance. In the following sections of this chapter, statement of the problem, purpose, and study, as well as the significance of the study, study conceptual scheme and hypothesis are presented.

1.3. Statement of the Problem

The escalation of accounting scandals has stimulated the need to develop the importance of accountability by setting up good corporate governance components. So, the association among corporate governance and financial performance has been intensely argued in the context of developed countries.

Thus, this study pursued to determine the correlation and effect among corporate governance components as (Board of directors, internal control system,

the external audit, transparency and disclosure, accountability and accounting control, and audit committees), and financial performance measured in terms of the combination of ten questions on return on equity in the last three years, return on assets in the last three years, return on the owner equity, return on investment compared to the previous three years, and the profit margin of operations. The most important study problems through the following questions:

1. What are the underlying components of corporate governance?
2. Do corporate governance components display significant sequential constancy?
3. Do corporate governance components differ in their comparative significance across commercial banks in Erbil?
4. Are corporate governance components significantly related to financial performance?
5. What are the effects of corporate governance on financial performance?

1.4. Purposes of the Study

- To identify the bases and rules necessary to establish an elaborate system for internal audit attuned to the demands of corporate governance.
- To present the role that the professional standards fulfill and their relations to the applications of corporate governance and controlling financial performance.
- To show the range of effect that autonomy in administering internal audit has on activating corporate governance components.
- To recognize the procedures and systems of good corporate and its role in activating corporate governance mechanisms.
- To state the roles of corporate governance components and their effects in controlling financial performance.

1.5. Significance of the Study

The reasoning of the study is shown by presenting the significant role of administering internal audit in activating governance according to new bases and concepts. This will lead to reducing the risks that the bank's encounter, especially

the recent experiences in the world showed that undermining governance in the banking systems will seriously lead to destroying the national economy. Therefore, activating corporate governance and initiating its principles in the banking system in Erbil city in the Kurdistan region of Iraq will develop the performance of the banking management which will reflect positively on the financial sector, and the movement of banknote market, and hence revival of the economy of the Kurdistan region.

1.6. Study Conceptual Scheme

Based on the review of the literature interrelated to the study variables corporate governance and financial performance, a conceptual Scheme is established for the study.

That bearing in mind the aims of the study is to examine the role of corporate governance in controlling the financial performance of commercial banks that affords a conceptualization of the main models related to the subject of the study and the relationships among them. The conceptual Scheme and hypotheses explaining the relationship and effect among these study variables are depicted in Figure 1.1 and described in subsequent sections.

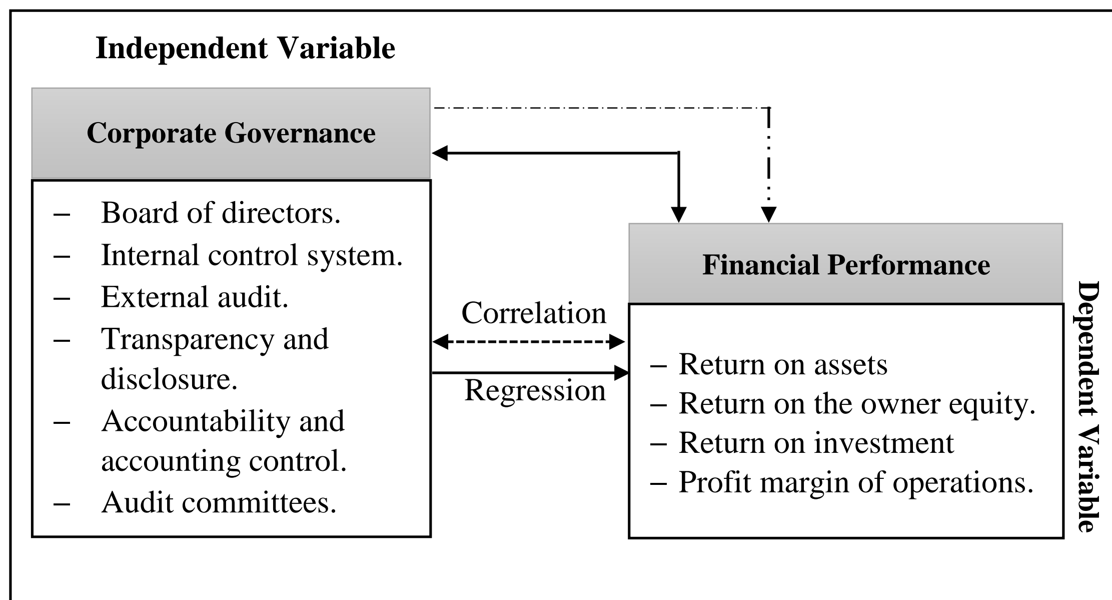

Figure 1.1: The conceptual Scheme of the study - Developed by researcher-based on literature

1.7. Hypothesis of Study

Conceptually, the study was established on the attitude that corporate governance components (Board of directors, internal control system, the external audit, transparency and disclosure, accountability and accounting control, and audit committees), effect in controlling the financial performance of commercial banks measured in terms of the return on equity, return on assets, return on the owner equity, return on investment, and the profit margin of operations. Therefore, the study seeks to test the following hypothesis based on the above study problem and objectives:

First main hypothesis: There is a rank significance of the study variables and dimensions, depending on the nature of dependency in commercial banks in Erbil city.

Second main hypothesis: There is a positive relationship between corporate governance and financial performance of commercial banks operating in Erbil city, at the level of $(0 \leq 0.05)$

H2.1: There is a positive relationship between board of directors and financial performance of commercial banks operating in Erbil city.

H2.2: There is a positive relationship between internal audit and financial performance of commercial banks operating in Erbil city.

H2.3: There is a positive relationship between external audit and financial performance of commercial banks operating in Erbil city.

H2.4: There is a positive relationship between transparency and disclosure and financial performance of commercial banks operating in Erbil city.

H2.5: There is a positive relationship between audit committees and financial performance of commercial banks operating in Erbil city.

H2.6: There is a positive relationship between accountability and financial performance of commercial banks operating in Erbil city.

Third main hypothesis: There is a statistically significant effect of corporate governance on financial performance of commercial banks operating in Erbil city at the level of $(0 \leq 0.05)$

CHAPTER TWO
LITERATURE REVIEW

2.1. Introduction

This chapter presents the review of several kinds of literature related to the extent of study variables. Thus, in the first section, it covers the concerns on corporate governance and corporate governance components as (board of directors, internal control system, the external audit, transparency and disclosure, accountability and accounting control and audit committees).

Then the second section offerings the literature associated with the financial performance of commercial banks in Erbil city.

2.1.1. Concept of Corporate Governance

Corporate governance represents and involves a set of relationships among a firm's management, its board, its shareholders and other stakeholders that are used to determine and control the financial direction and performance of organizations. Corporate governance also affords the structure through which the objectives of the company are set, and the means of conquering those objectives and observing performance are determined. At its core, corporate governance is concerned with pinpointing ways to guarantee that financial decisions are made efficiently. Therefore, corporate governance concerns arise due to the essential of counteracting agency problems and primarily from shareholders' efforts to protect themselves from the expropriation of their wealth.

Consequently, the term of corporate governance refers to the relationship among these three groups in determining the direction and performance of the corporation, (Wheelen and Hunger, 2014: 45).

2.1.2. Definition of Corporate Governance

There are different definitions for corporate governance. The most broadly used definition is the one given by OECD, which states that "Corporate governance is the structure by which business corporations are directed and controlled. The corporate governance structure identifies the distribution of rights

and responsibilities between different contributors in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs," (OECD, 1999:76).

Cadbury commission (1992) Identifying that corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the directors include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The Board's actions are subject to laws, regulations and the shareholders in general meeting, (Malik et al, 2014:139)

Hardman (1996) magnifies on this when he argues that corporate governance in the private sector is "concerned with the way the directors control the activities of the company and ensure that the managers to whom they delegate many functions are accountable, (Hardman, 1996:235).

Rezaee (2007) argued that corporate governance is traditionally viewed as a mechanism to synchronize both the management and the stockholders' interests. More specifically, the role of the corporate governance is to reduce the agency cost and to create a long-term value for the stockholders with the focus on both the board of directors' monitoring responsibility and the senior executives' managerial functions, (Dharmastuti and Wahyudi, 2013:133).

According to the Committee in their Report 1999 on Corporate Governance, is defined as, The process and structure used to direct and manage "the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interests of other stakeholders." (Singam, 2003:315).

While Keasey et al, (2005) defined corporate governance as the set of mechanisms, both institutional and market-based that induce the self-interested controllers of a company (those that make decisions regarding how the company will be operated) to make decisions that maximize the value of the company to its owners, (Keasey et al, 2005:251).

In the banking and financing sector, corporate governance includes the way banking institutions' business and affairs are managed by the board of administration and the top management, which affects how the bank works out the bank's objectives, plans and policies, taking into concern making appropriate economic returns for founders and other shareholders, day-to-day work management, protection of the rights and interests of recognized stakeholders (shareholders and depositors), companies' commitment to sound and safe professional behaviors and practices which are in conformity with regulations and legislations, (Linyiru, 2006:7). Corporate Governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that would foster good corporate performance, so corporate governance is about how to build trust and sustain confidence among the various groups that make up an organization. (Paul and Shammah, 2015:154).

2.1.3. The Importance of Good Corporate Governance in Commercial Banks

The importance of good corporate governance in commercial banks is in achieving many objectives (Qursh, 2009:122):

1. Creating and promoting confidence among depositors and shareholders on the one hand and the executive management on the other hand.
2. Implementing of corporate governance contributes to the protection of depositors' funds and small shareholders in particular .
3. Corporate governance considered as the terms and conditions of the classifications, the bank which is committed to international standards can be classified easily, which enhances the confidence of international financial institutions and by its performance.
4. Banks cannot apply the Basel standards (I, II) in accounting and audit without taking or stick to the principles of good Governance.
5. The auditing and control operations facilitated by the monetary authority and the international classification and assessment institutions.

According to (Dahmash et al, 2003:45) central bank's role in improving and developing corporate governance in banks, back to the following reasons:

1. The Implementation of good corporate governance lies within the supervisory responsibilities of the Central Bank.
2. The commercial banks are different from other corporations, because of the nature of its risk, in addition to the fact that these banks are responsible for maintaining the depositors' money.
3. As a result of exposure to these risks and because of banks traded on the stock exchange, the existence of corporate governance is important and necessary for these banks.
4. The board members in banks need to ensure that the risks to the nature of the business banks are managed properly and that the central bank has the legal responsibility to make sure of that. This does not mean that the board of directors should be the formation of risk management policies by itself, but the board must make sure that the approval of such policies.
5. We must acknowledge that is not easy to get independent board members and they can stand in the face of the shareholders controlling the bank's capital.
6. There is also a risk that appoints members of the board of directors so-called "semi-independent" to give a false impression of corporate governance.

2.1.4. Basel Committee on Standards Committee Basel Controlled Banks

The good practice of corporate governance leads in general, to support the safety of the banking system through standards set by the Basel Committee for the control of banks, regulate and control the banking industry, the most notably (Yusuf, 2007:45):

Promoting the strategic goals according to of the banking system, and determine the responsibility of management.

1. To ensure the efficiency of the board directors members and the full awareness of the concept of governance, and the absence of deliberate errors by top management.
2. To guarantee the effectiveness of the role of observers, aware of the importance of their oversight role .
3. The need to provide transparency and full disclosure of the business activities of the Bank and management alike.

2.1.5. The Components of Corporate Governance

The corporate Governance comprising of several dimensions but here we focused on the following dimension which believed that are more necessary with this topic:

2.1.5.1. Board of Directors

The board of directors has the power to engage, dismiss and compensate top-level managers, to ratify and monitor important decisions and to ensure that executive directors are pursuing the interests of principals. (Fama and Jensen, 1983:318).

The board of directors, with its legal authority to hire, fire and compensate top management, safeguards invested capital. Regular board meetings allow potential problems to be identified, discussed and avoided. Whilst nonexecutive directors are thought to be more independent, they may not always result in more effective corporate governance and may not increase performance. Different board structures are optimal for different firms. Moreover, the ability of the board to monitor the firm's executives is a function of its access to information (Nmai and Delle, 2014:211).

According to Fama (1980), the board of directors is viewed as an important tool to scrutinize the company manager‘s decisions. From the agency theory viewpoint, the role of the board of directors is to provide the most effective device to attain corporate governance that ensures their interests; in other words, it is instituted primarily in order to mitigate agency problems (Fama, 1980:292).

While (Aguilera and Cuervo- Cazurra, 2009:380) stated that the resource dependency theory sees the board of directors as a co-optative mechanism with

the role of calibrating the firm with external environmental demands. In the list it is 2009 Agency theory thus relies on a more basic understanding of human nature in contracting agreements and accords agents a more important role in firm performance.

Financial corporations are unlike than non-financial corporations in several proportions. First, their failure may have more serious consequences due to their unique position in financial intermediation and the payment system. Thus excessive risk-taking by banks can create significant negative externalities and systemic risk which is one of the reasons that the financial sector is more heavily regulated than non-financial sectors (Flannery, 1998:277).

The board independence is associated with the entry of outsiders into the board. The literature suggested that increases in the proportion of outside directors on the board should increase firm performance as they are more effective monitors of managers (Adams and Mehran, 2003:131). The major responsibilities of the board of directors are as follows (Wheelen & Hunger, 2014:45) :

1. Setting corporate strategy, overall direction, mission, or vision.
2. Hiring and firing the CEO and top management.
3. Controlling, monitoring, or supervising top management.
4. Reviewing and approving the use of resources.
5. Caring for shareholder interests.

2.1.5.2. The Role of Internal Control System

As (Alabede, 2012:117) notes the assessment of internal control system is critical to the effective discharge of the auditor’s role in corporate governance. Such assessment would afford him or her the opportunity of understanding the client’s control environment, which in turn will help him decide on the appropriate audit approach to adopt. Internal Control Revised Guidance Combined Code (2005) which followed Turnbull Report of 1998 places the responsibility for maintaining sound internal control system on the board of directors while the responsibility of the management is the implementation of the system. Internal control system facilitates the role of the external auditor by ensuring that company maintains quality financial reporting, (Alabede, 2012:118).

Consequently, weakness in internal control system makes the work of auditor more difficulty. Empirically, (Krishanan and Visvanathan, 2007:77) indicated that companies with weak internal control system witnessed more auditor changes. The consequence of weak internal control was manifested in the case of Baring Bank in which the general manager (Leeson) to Singapore office engaged in an unauthorized speculative trading on the Nikkei (Coyle, 2010). Internal control is considered another bastion of governance establishing a link between the external auditor and the board, reducing the risk of illegal activity and preventing fraudulent financial reporting. However, the effectiveness of corporate auditing is open to question (Clarke and Dean, 2007:210).

(Clarke and Dela-Rama, 2008:310) advocates, there is little evidence that audit committees will protect auditor independence and lead to improved financial reporting, rather they tend to serve a ceremonial function providing an external symbol of legitimacy. (Clarke and Dela-Rama, 2008:340) likewise, question the evidence of a link between audit committees and financial reporting quality, commenting that though there are a number of potential impacts on aspects of internal control, internal audit and risk management, there is little understanding of how these impacts are achieved. More needs to be known about the complex environment in which audit committees operate, and their interaction with other parties including executive management and external auditors.

The corporation's internal control system is important to ensure the integrity of financial reporting and to check systems are appropriate to monitor and manage risk. The board has primary responsibility for internal control, although it is often delegated to its audit committee. In this circumstance, the corporation's internal auditor evaluates internal controls and reports directly to the audit committee. In an effort to improve the financial literacy of audit committee members, a former audit partner has sometimes been employed, which has a positive effect on internal control systems (Naiker and Sharma, 2009:570).

According to (O'Leary et al, 2006:7). The control environment encompasses management's philosophy and operating style, organizational structure, human resource and levels of authority, internal audit, audit committee and the use of information technology. For control procedures, there should be segregation of duties, authorization procedure, safeguards for assets and documentation.

2.1.5.3. The Role of External Audit

An external audit of corporate operations and financial statements in most countries has legislative backing. A corporate audit by the external auditor is made compulsory through laws to address agency problem arising from the separation of ownership from corporate management (Alabede, 2012:115). External audit is also regarded as an important cornerstone of corporate governance, mainly with respect to the prevention and detection of fraud and errors in financial statements (Davidson et al, 2005:248).

Therefore, external auditors play a valuable role in the governance of corporations. More recently, there has been increased emphasis and regulatory attention on the need for independence on the part of the external auditor, with a focus on the level of consultancy services and other non-audit services (NAS), offered to audit clients and on the length of auditor tenure, (Frankelet al, 2002:84).

Hence, Audit fees are associated with client size and complexity, and the risk is associated with the audit (Hay et al, 2006:147). To determine the appropriate audit fee, auditors assess the risk associated with the client and plan their work accordingly (Bedard and Johnstone, 2004:291).

As a result, firms with greater income-increasing discretionary accruals tend to pay a higher audit fee (Abbott et al, 2006), whereas firms with higher-quality CG and a financial expert on the audit committee pay less (Krishnan and Visvanathan, 2009:118).

2.1.5.4. The Role of Transparency and Disclosure

Transparency is integral to corporate governance, higher transparency reduces the information asymmetry between a corporation’s management and financial stakeholder’s (equity and bondholders), mitigating the agency problem in corporate governance (Patel et al, 2002:331).

The concept of Bank transparency is broad in scope it refers to the quality and quantity of public information on a bank’s risk profile and to the timing of its disclosure, including the banks past and current decisions and actions as well as its plans for the future. The transparency of the banking sector as a whole also includes public information on bank regulations and on safety net operations of the central bank (Enoch et al, 1997:9). Consequently, weak transparency makes

banks’ asset risks opaque. Stock market participants including professional analyses such as Moody’s encounter difficulties in measuring banks credit worthiness and risk exposures (Poon et al, 1999:273).

While (Ball, 2001:139) claims that timely incorporation of economic losses in the published financial statements (that is, conservatism) increases the effectiveness of corporate governance, compensation systems, and debt agreements in motivating and monitoring managers. For instance, improved governance can manifest in a reduction of the private benefits that managers can extract from the company or in a reduction of the legal and auditing costs that shareholders must bear to prevent managerial opportunism.

Accordingly, the agent responsible for the lack of transparency may be a government minister, a public institution, a corporation, or a bank. Thus, a working understanding of transparency should encompass such attributes as access, comprehensiveness, relevance, quality, and reliability. (Vishwanath, Kaufmann, 2001:42).

2.1.5.5. Accountability and Accounting Control

Corporate governance is concerned with the structures and processes associated with, for example, production, decision-making, and control within an organization. Accountability, which is a sub-set of governance, involves the monitoring, evaluation, and control of organizational agents to ensure that they behave in the interests of shareholders and other stakeholders (Keasey and Wright 1993:293). According to (World Bank, 1991:9) Accountability means holding a person responsible for his/her actions and is gauged from financial and economic performances, and voice mechanism. Financial accountability involves the use of accounting and auditing covenants.

Therefore, corporate governance is based on a set of attributes, including ensuring accountability to shareholders or stakeholders (Keasey and Wright, 1997:212), creating mechanisms to control managerial behavior (Tricker, 1994:301), ensuring that companies are run according to the laws and answerable to all stakeholders.

According to Kyereboah-Coleman (2007), external stakeholders such as customers, suppliers, and the community are equally important, and also

constrained by formal and informal rules that business must respect. Permitting to stakeholders theory the best corporations are ones with committed suppliers, customers, and employees and management. Recently, stakeholder theory has received attention than earlier because researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders (Kyereboah-Coleman, 2007:34).

2.1.5.6. The Role of Audit Committees

There has been growing recognition in recent years of the importance of corporate governance in verifying detailed financial reporting and deterring fraud. The audit serves as an observing means and is thus part of the corporate governance mosaic (Cohen et al, 2002:580). (DÜZTAŞ, 2008:53) claimed that "audit committees play an essential role in challenging those practices that have the potential to undermine the quality of financial reporting." In addition, by performing the attest verification function, auditors are a significant part of a firm's monitoring system and thus can also be considered an essential component of the corporate governance mosaic.

Therefore, in principle, auditors must work with other actors in the corporate governance mosaic to ensure that stakeholders receive the highest quality financial reports as well as help to protect the interests of current and future shareholders and investors. For instance, the auditor must work with the audit committee to assess and promote financial reporting quality (Cohen et al, 2002:581).

Audit committee size refers to the total number of banks' audit committee members. The size of audit committee affects banks' performance. Small size audit committee ensures effective monitoring (Aldamen et al, 2011:5). It is likely that small size audit committees effectively communicate in the financial reporting process and problems to be resolved easily.

As a tool of corporate governance audit committee also has a role in risk management. (Turley and Zaman, 2004:307) ascertained that audit committee should be responsible for reviewing the management's assessment of internal and external business risks. Moreover, audit committees perform corporate

governance in India were found effectively managing the future risk by using 'whistle blow' policy which cautions all the concerned parties about the uncertain happenings in future that may include fraud (Puri et al, 2010:49). Furthermore, (Vera-Muñoz, 2005:120) concluded that good corporate governance requires an effective audit committee whose members have a general understanding of the company's operations and financial risks. A reach detailed study by (Braiotta et al, 2010:188) dedicated a very extensive and valuable work to the role of the audit committee and its practices in the context of corporate governance.

2.1.5.7. The Role of Internal Audit

(Millichamp, 2000:349) defined internal auditing as an independent appraisal function within an organization for the review of the system of control and the quality of performance as a service to the organization. It objectively examines, evaluates and reports on the adequacy of the internal control system to the proper economic, efficient and effective use of resources.

The new definition shifts the focus of the internal audit function from one of assurance to that of value added and attempts to move the profession toward a standards-driven approach to a heightened identity (Krogstad et al, 1999:28).From the above definitions, it is clear that the internal control is not just a one-sided tool for controlling the order and rightness of certain situations, but it is a method of detecting the value added up to a company, achieving the index of effectiveness and profitability of the company (Nagy and Cenker, 2002:131).

Accordingly, in today's business environment internal auditors are now providing management with a far broader range of information concerning the organization's financial, operational and compliance activities to improve effectiveness, efficiency, and economy of management performance and activities (Rezaee, 1996:32).

Some firms maintain the internal audit function 'in house', while others prefer to outsource it or to use some combination of the two. An in-house internal audit function is likely to be more effective given greater familiarity with the systems in place: it can identify weakness in the internal control system and ensure remedial action is taken, and it is more likely to detect and report on fraud (Coram et al, 2008:546).

2.1.6. Theories of Corporate Governance

The agency, stewardship and stakeholder theories signify contradictory understandings on conflict of interest in exercise stewardship delegated to management by shareholders. Corporate governance supports more towards the agency theory recognizing the significance of checks and balances to guarantee that organizational (bank) assets are healthy protected by the board on behalf of the shareholders.

2.1.6.1. Agency Theory

Agency is a deal under which one or more persons (principals) involve other persons (agents) to perform some services on their behalf that involves delegating some decision-making authority to the agents (Jensen and Meckling, 1976: 329). Large corporations, mainly publicly listed companies, generally have an organizational framework wherein there is an essential separation of ownership and control between principals and agents. In the relationship between them, the owners (principals) hire managers (agents) to run the firm in their best interests, compensating the latter for their efforts, generally in pecuniary form (e.g. salary and bonuses (Hart, 1995:679).

Although Sappington (1991) stated that conflicts of interest can arise in this relationship due to the difference of the interests of managers and shareholders. The potentially problematic relationship between principals and agents has been conceptualized and explored using the agency theory (Sappington, 1991:57).

The major premise of agency theory is that conflicts of interest arise in corporate relationships due to the disagreement of the interests of managers and shareholders (whereby the agents are expected to be rational but opportunistic). The core assumptions of agency theory are that:

1. Managers may maximize their own efficacy instead of enhancing shareholder value (Demsetz, 1983:379).
2. Contracts are not costless when writing and enforcing (Fama and Jensen, 1983:332).
3. Information is distributed unequally between principals and agents.
4. The parties have limited or bounded reasonableness (Berle, and Means, 1932:122).

Consequently, the theory holds that due to the asymmetric information distribution between managers and shareholders, principals cannot correctly measure the efforts of managers who know the details of the operations of the firm (i.e. it is at the expense of the shareholders, although both parties might incur some costs).

It is an acknowledged fact that the principal-agent theory is generally considered the starting point for any debate on the issue of corporate governance emanating from the classical thesis on The Modern Corporation and Private Property by (Berle, and Means, 1932:123).

2.1.6.2. Stewardship Theory

The stewardship theory argues against the agency theory speculates that managerial opportunism is not relevant (Donaldson and Davis, 1991:51). According to the stewardship theory, a manager's objective is primarily to maximize the firm's performance because a manager's need for achievement and success are satisfied when the firm is performing well, (Davis et al, 1997:24).

One key distinctive feature of the theory of stewardship is that it replaces the lack of trust to which agency theory refers with respect for authority and inclination to ethical behavior. The stewardship theory considers the following summary as essential for ensuring effective corporate governance in any entity, (Muth and Donaldson, 1998:15):

- Stewardship theory is based on a model of man where a steward perceives greater utility in cooperative, pro-organizational behavior than in self-serving behavior.
- The theory assumes a strong relationship between organizational success and a principal's satisfaction. Hence, a steward overcomes the trade-off by believing that working towards organizational, collective ends meet personal needs.
- Empowering governance mechanisms are appropriate for the model of a man to which stewardship theorists adhere.

Thus, control lowers a steward's motivation and undermines pro-organizational behavior. While the experiential researchers, depending on whether

they assume managers to be agents or stewards, have arrived at different conclusions, with which they attempt to validate a single best way for corporate governance. Hence, authors discuss situational and psychological mechanisms underlying the two models of man: agent and steward (Davis et al, 1997:26).

Stewardship theory focuses on psychological and sociological methods of oversight, rather than the economic (pecuniary) tools of agency theory. The former holds that organizational members have some form of positive collective identity that engenders trustworthy behavior (Davis and Donaldson, 1997:154).

(Muth and Donaldson, 1998:15) agrees in that financial gain is not necessarily the sole driver of managerial behavior, and in addition, managers require some discretion to effectively manage the business for shareholders. Accordingly, separate ownership is not viewed as a weakness in stewardship theory as cooperative behaviors are held to be the latent/intrinsic behavior of managers (Davis, 1991:51), and they are subject to an array of motives in addition to financial gain (Muth, and Donaldson, 1998:16).

Stewardship theory posits that concern for their own reputations and career progression inhibits agents from acting against the interests of shareholders, thus agency costs should be inherently minimized (Donaldson and Davis, 1994:155). The contribution to the firm performance of stewards relates to the perspective in terms of socio-cultural and psychological factors (Clarke, 2004:120).

2.1.6.3. Stakeholder Theory

The stakeholder theory then appears better in clarifying the role of corporate governance than the agency theory by underlining the various constituents of a firm. Thus, creditors, customers, employees, banks, governments, and society are regarded as relevant stakeholders. Related to the above discussion, (John and Senbet, 2004:375), provide a comprehensive review of the stakeholders' theory of corporate governance which points out the presence of many parties with competing interests in the operations of the firm. They also emphasize the role of non-market mechanisms such as the size of the board, committee structure as important to firm performance.

One argument against the strict agency theory is its narrowness, by pinpointing shareholders as the only interest group of a corporate entity

necessitating further exploration. Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders. For instance, (McDonald and Puxty, 1979:58), offered that companies are no longer the appliance of shareholders alone but exist within society and, hence, has responsibilities to that society. One must, however, point out that large recognition of this fact has rather been a recent phenomenon. Indeed, it has been realized that economic value is created by people who voluntarily come together and cooperate to improve everyone's position (Freeman et al, 2004:365).

(Silveira et al, 2005:37) claimed that stakeholder theory is based on sociology and the first use of stakeholder word occurred in 1963, in a memorandum from the Stanford Research Institute. Freeman and Reed (1983) state that "management thought has dramatically changed in recent years. There have been, and are now underway, both conceptual and practical revolutions in the way that management theorists and managers think about organizational life". Those authors have proposed two definitions of stakeholders: a wide and a narrow sense. The wide sense stakeholder includes "any identifiable group or individual who can affect the achievement of an organization objectives" whereas the narrow sense includes any identifiable group or individual on which the organization is dependent for its continued survival (Freeman and Reed, 1983: 88).

Freeman and Reed (1983) also defined the stakeholder as any group or individual that influences or is influenced by the firm's ability to achieve its own objectives. This concept embraces, in a wide way, all the agents who interact with the firm (Freeman, and Reed, 1983:89).

The stakeholder theory supported that management decisions should balance and satisfy the interests of all stakeholders. This is not a consensual subject (Silveira et al, 2005:38). Straight, though, many authors have tracked the idea of (Jensen, 2001:16), for example, state that a company cannot maximize its value if it ignores the interests of its stakeholders, while (Gibson, 2000:251) trusts that the stakeholders theory is relevant and commonly used when analyzing business ethics.

2.1.7. Corporate Governance Mechanisms

2.1.7.1. Internal Corporate Governance Mechanisms

Internal corporate governance looks at the allocation of power and internal mechanisms designed to protect shareholders without undermining those who need to manage the corporation:

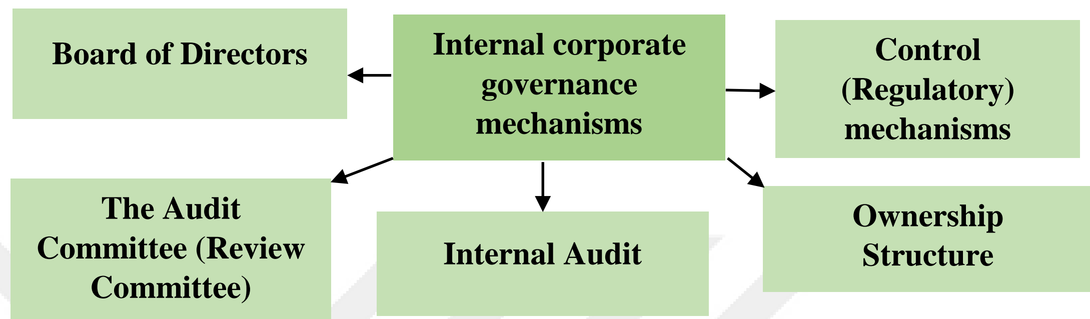

Figure 2.1: internal corporate governance mechanisms
Source: developed by researcher base on literature.

1. Board of Directors:

Firms in most countries have a board of directors. In the most countries, the board of directors is specifically charged with representing the interests of the shareholder. Board of directors is the heart of corporate governance (Lawal, 2012:26). Boards of directors are the agent of the shareholders and their primary task is to monitor and control firm management on behalf of shareholders to reduce agency problem (Jensen and Meckling, 1976:311).

The board exists primarily to hire, fire, monitor, and compensate management, all with an eye toward maximizing shareholder value. While the board is an effective corporate governance mechanism in theory, in practice its value is less clear (Denis and McConnell, 2003:2).

Another internal corporate governance mechanism is managerial compensation: extensive empirical evidence identifies a strong relation between firm performance and executives' performance-based compensation, suggesting that compensation can align the interests of managers and shareholders (Mayers and Smith, 2010:303).

Those mechanisms' are the board of directors, proxy fights, large shareholders, hostile takeovers and financial structure. The board of directors is

elected by the shareholders "to act on their behalf, and the board, in turn, monitors top management and ratifies major decisions" (Hart, 1995:681). Because the board of directors may fail on its monitoring activity, shareholders can replace them, and the standard way to do it is through a proxy fight: "a dissident shareholder puts up a slate of candidates to stand against management's slate, and tries to persuade other shareholders to vote for his (or her) candidates" (Hart, 1995:682).

2. The Audit Committee (Review Committee)

The audit committee is a sub-committee of the board of directors and its primary role is to monitor and review financial statements (Yammeesri and Herath, 2010:284). An audit committee has a specific role of ensuring that the interests of shareholders are properly protected in relation to financial reporting and internal control (Habbash, 2010:63).

The audit committee mainly functions to regularly meet with auditors (internal and external) to review audit routes, financial statements, and internal accounting controls. Clearly, this contributes to the reduction of information asymmetry and consequently agency costs by allowing for the timely disclosure of verified accounting information to shareholders (Klein, 1998:284).

Accordingly, Monitoring is performed by external audit and audit committees. The existence of an audit committee improves the monitoring of corporate financial reporting and internal control and it helps to promote good corporate governance, in turn, this improves firms' financial performance by reducing agency cost (Sa'eed and Mahamid, 2011:47).

(Manini and Abdillahi, 2015:32) recognize that the audit committee plays a significant role in the monitoring process carried out by the directors of the firm and auditing is used by firms to reduce agency costs. In addition to that, they revealed that most essential board decisions originate at the committee level, and this includes the audit committee.

(Kyereboah, 2007:9) describe that size of the audit committee could be an indication of the seriousness attached to issues of transparency by the organization. In addition. It is evident that the increased responsibilities of the Audit Committee have resulted in longer and more frequent meetings of the

Committee (Carcello et al, 2002:295). Summarize some of the principal roles of the Audit Committee, including oversight of the Internal Audit Department, Practical suggestions to improve the effectiveness of the Audit Committee are provided.

An effective audit committee strengthens the position of the internal audit function by providing an independent and supportive environment and reviews the effectiveness of the internal audit function. External audit is also regarded as an important cornerstone of corporate governance, particularly with respect to the prevention and detection of fraud and errors in financial statements (Davidson et al, 2005:246).

3. Internal Audit

Internal audit must thirdly be independent of all decisions factors involved in corporate governance, in this regard accomplishment being audited must be independent from everyday internal processes, and must be able to exercise its consignment on its own initiative in all departments, establishments and functions of the institute (Changwony, and Rotich, 2015:17).

The new definition of internal auditing focuses on corporate governance, especially the board of directors. This definition emphasizes internals' audit role in aiding the entity to achieve its objectives. Because of the fact that the board of directors is ultimately responsible for the entity's accomplishment of its objectives, the internal auditor's contribution is to providing information to that group (Colbert, 2002:149).

The head of the internal audit function should report directly to the audit committee and only on an administrative basis to the CFO, CEO, or their equivalent. This enhances the independence of the internal auditors. The director of the internal audit and his or her staff of internal auditors should be competent professionals (Locatelli, 2002:13).

Therefore, internal auditing helps corporate governance by revising the organization's code of conduct and ethics policies to ensure they are current and are communicated to employees. From the above, it is clear, that internal auditing develops ever-new approaches to internal auditing, devises new auditing products and services, and helps fulfill increasingly more complex demands that management nowadays faces. Related to that, it can be expected that internal

auditing will be increasingly oriented towards advising the management on efficient corporate governance (Mohammed et al, 2014:9).

Basel committee's (2012), principles for enhancing corporate governance states that bank should have an internal audit function with sufficient authority, stature, independence, resources and access to the board of directors. Independent, competent and qualified internal auditors are vital to sound corporate governance.

4. Ownership Structure

(Salami, 2011:113) investigated how ownership structure and existence of conflicts of interests among shareholders operating within a poor governance system, impacted on company profitability. His paper, using panel data and regression models, concluded that firms with low ownership concentration showed low firm profitability. This stand was supported by (Sorensen, 2007:7). who examined the effects of ownership dispersion on cost efficiency, using empirical evidence, and concluded that corporate governance failure suggested that dispersion and indirect ownership weakened incentives to control the corporation, leading to agency losses and inferior performance.

Investors are commonly divided into two types: the individual and the institutional investors. Institutional ownership has very important roles in the corporate governance, especially in relation to its ability for monitoring, gaining information and its impacts towards both corporate policies and performance. Some empirical studies that have been conducted in relation to the monitoring ability of institutional ownership are (Cornett et al, 2007:7) who have pointed out that institutional investors may differ from individuals in terms of the stock quantity and their expertise in gaining information and managerial monitoring. The role of the institutional ownership in influencing the strategic corporate policies is analyzed by (Denis and Osobov, 2008:63), (Tihanyi et al, 2003:199). Who state that corporate strategic decision diversification is the representation of the corporate decisions where conflicts of interests between the managers and stockholders lie.

However, more recent studies do not provide much support that concentrated ownership matters. For instance, (Grove et al, 2011:419) only find a weak association between concentrated ownership and bank performance. (Erkens

et al, 2012:395) an indication that financial corporations with greater institutional ownership took more risk before the crisis and subsequently suffered larger losses over the period 2007-2008. Similar findings are reported by (Beltratti and Stulz, 2012:10). They document a strong relation between concentrated ownership and bank risk-taking during the recent mortgage crisis in the US.

Consequently, ownership may enable CEOs controlling the composition of the board and lessening its monitoring role. Indeed, for a sample of 1583 UK non-financial companies in 1996-97 (Lasfer, 2006:1012) finds that managers use their ownership power to select a board that is unlikely to monitor.

5. Control (Regulatory) Mechanisms

Conferring to (Mihaela and Lulian, 2012:2) the internal control can be achieved by foreign entities or by the internal department. Under the French Commercial Code, the auditor must publicly justify, together with a report on the annual accounts, the audit opinion. This justification includes assessments on internal control processes. Public Company Accounting Oversight Board (PCAOB) is a nonprofit organization created after entry in force of the law Sarbanes-Oxley from the United States to oversee audits of public companies. According to P.C.A.O.B., the auditor is required to present an opinion regarding the entity's internal control quality and also this view is part of a financial statements audit. This requirement is not mentioned in the International Auditing Standards. Consequently, from the agency theory viewpoint, corporate governance improves corporate performance by resolving agency problems through monitoring management activities, controlling self-centered behaviors of management and inspecting the financial reporting process (Habbash, 2010). Corporate governance mechanisms and controls are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. There are both internal monitoring systems and external monitoring systems (Sytse and Hein, 2013).

An ideal monitoring and control system should regulate both motivation and ability while providing incentive alignment toward corporate goals and objectives. Care should be taken that incentives are not so strong that some individuals are tempted to cross lines of ethical behavior, for example by manipulating revenue

and profit figures to drive the share price of the company up (Sytse and Hein, 2013:322). Although the accounting profession has always had a strong focus on internal controls, recent spectacular business failures which have undermined auditors' credibility in their reporting function, have eroded public confidence in the accounting and auditing profession. (Brief et al, 1996:188).

2.1.7.2. External Corporate Governance Mechanisms

The corporate governance has two external governance mechanisms these are used in the modern corporation:

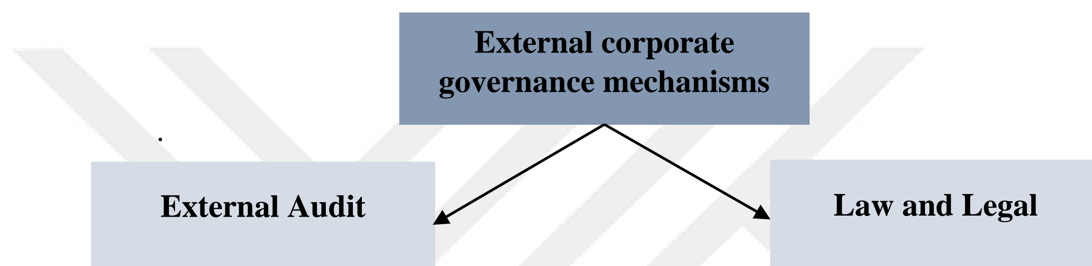

Figure 2.2: external corporate governance mechanisms

Source: developed by researcher base on literature.

1. External Audit

For the shareholders and other stakeholders to believe in the financial statements, it is imperative to appoint an independent expert to audit the financial statements, hence the role of external auditors in corporate governance. The role of the external auditors in sustaining good corporate governance is widely acknowledged, (Coyle, 2010).

(Cadbury, 2000:8) acknowledged that “the annual audit is one of the cornerstones of corporate governance. The audit offers an external and objective check on the way in which the financial statements have been prepared and presented.” Through the role of the external auditor, the shareholders monitor and control the management and this helps to enhance transparency in a company (Alabede, 2012:116). Another issue surrounding the role of the auditors is the gap between public expectation and their assumed role particularly in the detection of fraud (Alabede, 2012:117).

Stakeholders expect the auditors to detect and report material frauds while the auditors have always claimed that detection of fraud is incidental not the primary role of auditors. (Sikka et al, 1998:232) stated that this issue has remained controversial and has lower credibility and prestige of the auditors' work. Even then, studies show that some shareholders still have regard for audited financial statements because it contains some degree of credible information (Kothra, 2001:140).

Hence, Coffee has emphasized the role of the auditor as a gatekeeper and suggested that auditor independence in the United States has become compromised by a confluence of circumstances:

1. The diminishing legal risks from fraudulent or negligent audits throughout the 1990s (undermining deterrence and increasing acquiescence).
2. The massive increase in the provision of non-auditing services (exposing the auditor to low-visibility sanctions, creating the possibility of auditing services being offered as a loss leader, placing increasing pressure on auditing to become a profit center).
3. Increasing concentration in the auditing industry (inducing a "race to the bottom," where no auditing firm finds a competitive benefit from increasing its integrity).
4. The stock boom of the late 1990s (leading to an exuberant market where auditing might have been considered a mere nuisance by management and of little value to the euphoric investor).
5. Principal/ agent problems within the auditing firm due to the use of incentive fees and bonuses in conjunction with the increase in consulting services (providing a strong incentive to the individual partner to circumvent internal monitoring).
6. The over-reliance on a simple certification of compliance with GAAP rules rather than the provision of an opinion of a firm's true and fair financial position (2002). (Marnet, 2005:618).

2. Law and Legal

As (Ewing, 2005:324) identified, perhaps the most important external governance control mechanism is the existence of a robust legal environment. In

the case of banking, this would mean that a detailed and comprehensive set of legislation, which is impartially enforced so as to protect investor rights, should be in place. Undoubtedly, some scholars believe that China has made good progress towards establishing a sound rational-legal framework which has reduced the influence of personal connections on business decision making (Guthrie, 1998:269).

Conversely, in the banking sector it is notable that the CBRC, working with high profile foreign advisors such as Howard Davis (former Chairman of the UK Financial Services Authority) Gerald Corrigan (Managing Director of Goldman Sachs) and Jamie Caruana (Director of the IMF Monetary and Capital Markets Department) has been heavily involved in developing national legislation in the financial sector. Some of the key areas of development have been the introduction of the Anti-Money Laundering Law, the Anti-Monopoly Law and the Banking Supervision Law (Nolan, 2010:18).

Consequently, the difficulty with legal compliance mechanisms is that many cases of abuse that have enraged the public are entirely legal, for example, companies can file misleading accounting statements that are in complete compliance with Generally Accepted Accounting Principles (GAAP). (Arjoon, 2015:5).

Accordingly, new insights from recent international corporate governance studies suggest that the relative inefficiency of external governance mechanisms in several countries, specifically the legal environment, leads local firms to compensate with ownership concentration, suggesting that ownership concentration and the legal system act as substitutes (Shleifer and Vishny, 1997:770) The interaction of all these mechanisms, both external and internal to the firm, makes the task of disentangling their incentive effects more difficult.

2.1.8. The Corporate Governance Implementing Parties

There are some major parties are pretentious by and affect the proper implementing of the corporate governance and determines to a large degree how success or failure in applying the proper corporate governance, these parties are:

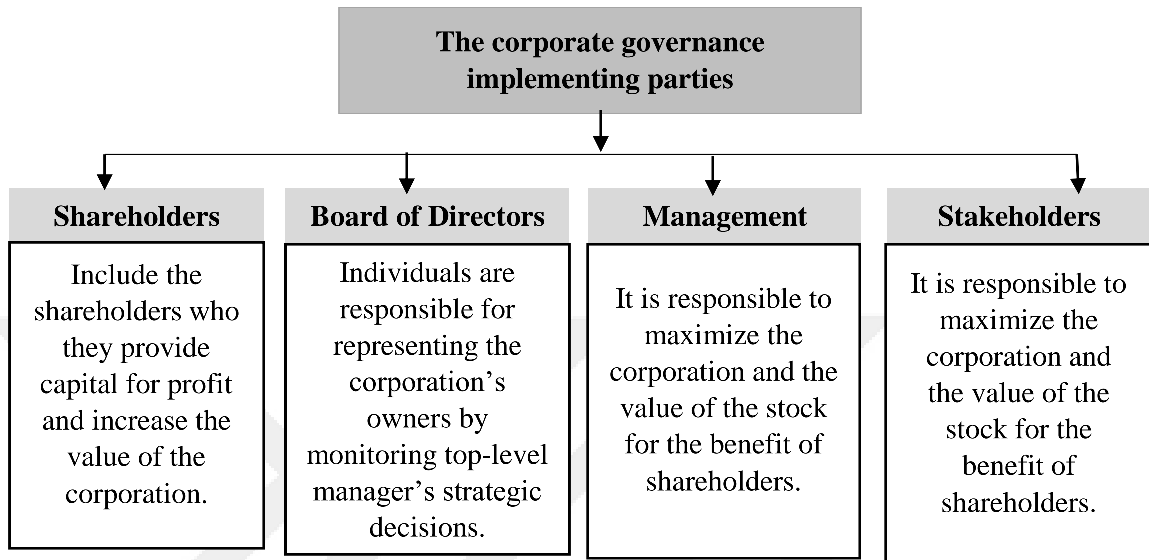

Figure 2.3: The corporate governance implementing parties

Source: Ghallab. (2011). "The roles of the audit function in the area of corporate governance to reflect the principles and criteria for sustainable development: a study of some industrial enterprises, master thesis, Economics and strategic business management for sustainable development, University of Ferhat Abbas, p1.

Shareholders: those who provide capital for the corporation through their ownership of shares and to maximize the value of the corporation in the long run, which determines the extent of continuity in return for adequate profits for their investments and they have the right to choose the members of the board of directors the right to protect their rights, (Hussein, 2005:32).

The Board of Directors: who represent the shareholders, the Board is the one who selects executives as well as control over their performance and policy-making for the corporation and how to maintain shareholders' equity (Sheikh, 2012:56).

According to (Wheelen & Hunger, 2014:45) the board of directors, therefore, has an obligation to approve all decisions that might affect the long-run performance of the corporation. This means that the corporation is fundamentally governed by the board of directors overseeing top management, with the

concurrence of the shareholder. The term corporate governance refers to the relationship among these three groups in determining the direction and performance of the corporation.

Management: The management is the Responsible in the company to submit reports on the effective functioning of the Board of Directors, and the management also responsible for maximizing the profits of the corporation (the bank) and increase their value addition to its responsibility towards disclosure and transparency in information published by the shareholders, and management is the link between the board of directors and other parties dealing with the corporation, (Suleiman, 2006:122).

Moreover, the top management responsibilities, especially those of the CEO, involve getting things accomplished through and with others in order to meet the corporate objectives. Top management's job is thus multidimensional and is oriented toward the welfare of the total organization. Specific top management tasks vary from firm to firm and are developed from an analysis of the mission, objectives, strategies, and key activates of the corporation, (Hitt et al, 2007:329).

Stakeholders: a group of parties' interests within the corporation (the bank) such as creditors, suppliers, and employees, the interests of these parties may be different and sometimes contradictory. Corporate governance concept is influenced heavily by the relationships between these parties (Ali and Shehata, 2007:88)

2.1.9. Principles of Corporate Governance

The main thrusts of the OECD principles are for the improved release of important information to shareholders and vigorous protection of shareholder interests, especially those who hold a minority interest or are located abroad. The report stops short of advocating far-reaching reforms of existing systems of corporate governance or legal systems even though it recognizes significant limitations in some countries. These limitations are perhaps entrenched in the governance environment in some countries (Emmons and Schmid, 1999:5).

- **Protect the Rights of Shareholders**

The first OECD principle is to protect the rights of shareholders, that a vital issue in the concept and principle of corporate governance, (Murphy and Topyan, 2005:82) identified that the most important aspect of corporate governance is to protect the small shareholders who are not active, rather than the large and active shareholders. Procedures that protect shareholders lead to confidence in the institution (Klapper and Love, 2004:714). These procedures include maintaining clear shareholder records and applying guaranteed methods to register property; providing information on a timely and regular basis; ensuring shareholders' rights to participate and vote in general shareholders meetings; and selecting members of the board (King and Wen, 2011:519). The launching of good corporate governance controls prevents shareholders from gaining more control in countries where investor protection is low; this is reflected in measures of performance and market valuation (Doidge et al, 2004:220).

(Mallin and Melis, 2012:172) stress that competent boards should manage the company and ensure that effective strategies are prepared for the company's overall corporate performance and long-term sustainability because shareholders are the providers of risk capital and need to protect their investments, while (John et al, 2008:1707) suggest that firms with better shareholder protection are more likely to engage in riskier investments that can create firm value.

According to (King and Wen, 2011:519), companies should ensure shareholders' rights to participate and vote in general shareholders meetings and select members of the board. Shareholders should also be provided with information that is relevant and material to the firm on a timely and regular basis (through the annual general meeting notice).

- **Fair and Equal Treatment of all Shareholders**

The second principle prescriptions that corporate governance should ensure the equitable treatment of all shareholders are including minority and foreign shareholders. Strong implementation of corporate governance may enhance the corporation's ability to protect the minority shareholders' rights (Chhaochharia and Laeven, 2009:407).

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for the violation of their rights (OECD, 2004). The equitable treatment of all shareholders demands transparency with respect to the distribution of voting rights and the ways that voting rights are exercised. This principle also requires the disclosure of any material interests that management and board members have in transactions or matters affecting the corporation (Nestor and Jesover, 2000:7).

(Santiago-Castro and Brown, 2011:439) investigate the relationship between the expropriation of minority shareholders' rights and firm performance in Latin American markets. They find that a lack of investor protection in emerging markets might cause the expropriation of minority shareholders' rights, leading to poorer performance.

Shareholders should have the opportunity to receive effective redress for violations of their rights. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders, whether directly or indirectly (Cheunget al, 2011:166). Further, internal control systems need to be established to prohibit the use of inside information (Givoly and Palmon, 1985:72).

- **The role of Stakeholders in Corporate Governance**

The third principle focuses on the relationship between the corporation and stakeholders in creating value (OECD, 2004). (Sueyoshi et al, 2010:720) examined the relationship between governance variables, particularly composition and functions of the board of directors, and operational efficiency in Japanese firms. They found that efficient practices under the rules of corporate governance increase the value of the corporation.

Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policymakers (OECD, 2011).

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises. The stakeholders' principle focuses on the relationship between the corporation and stakeholders in creating value (OECD, 2004). This principle should cover the role of stakeholders to reflect the interaction with, and treatment of, stakeholders such as employees, creditors, suppliers, shareholders and the environment (Cheung et al, 2011:168).

(Jensen, 2010:37) states that a firm cannot maximize its value if it ignores the interests of its stakeholders. Consequently, stakeholder engagement associated with firm performance can be enhanced if the framework of stakeholder engagement provides an effective management system for corporate stakeholder engagement within the company (Sinclair, 2011:7).

The management has a responsibility to ensure that shareholders receive a fair return on their investments; it also has a responsibility to all stakeholders and should manage and alleviate the conflicts of interest that may exist between the firm and its stakeholders (Prugsamatz, 2010:38). Directors should be in a position of trust and should manage the company in a way that creates long-term sustainable value, while simultaneously considering their relationships with wider stakeholder groups the including employees, customers, suppliers and communities that their activities affect. Stakeholder relationships have direct and indirect effects on firm performance (Berman, Wicks, Kotha and Jones, 1999:492).

❖ **Disclosure and Transparency**

The fourth principle is that corporate governance should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company (OECD, 2004).

A company information disclosure that consists of corporate performance disclosure and financial accounting disclosure is the principal means through which companies become transparent to all stakeholders (Gill et al, 2009:15).

The disclosure and transparency should show that the existence of policies and instructions are in line with the laws and a regulation relating to the company and the nature of the business (Shanikat and Abbadi, 2011:95). Therefore, transparency and disclosure are significant and fundamental features of corporate governance, which means that good disclosure practice is a form of good corporate governance. This is because the market might expect more serious information asymmetry problems if a company has poor information disclosure and transparency practices (Chen et al, 2007:648).

While, (Patel et al, 2002:327) report that higher transparency and better disclosure reduces the information asymmetry between a firm's management and stakeholders. Their results suggest that companies with lower transparency and disclosure are less valued than companies with higher transparency and disclosure.

(Chi, 2009:11200) states that better transparency and disclosure practices establish a stronger corporate governance practice, which leads to good corporate performance. Chi implies that the quality of corporate disclosure practice has a positive relationship with firm performance. (Chiang and Chia, 2005:97) also find that corporate transparency has a significant positive relationship with firm performance, concluding that transparency is one of an essential indicators for evaluating corporate performance.

❖ **The responsibilities of the Boards of Directors**

The fifth principle outlines the responsibilities of the board of directors that ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and shareholders (OECD, 2004).

The main responsibilities of the board are to make decisions on the business operations of the company and to manage the activities of the directors (Jang and Kim, 2001:8). The board of directors should be a well-functioning and effective board because it is an important aspect in enhancing corporate governance in market systems (De Andres et al, 2005:199). The board of directors is responsible for formulating policies and strategies and supervising the operations of the company as its top executive unit (Ahmed and Gabor, 2012:7).

In addition, board members should direct and control the affairs of the company, act on a fully informed basis and in good faith with the best interests of the shareholders and all other stakeholders, and ensure compliance with applicable laws by management, shareholders and stakeholders (Awotundun et al, 2011:103). This implies that the board acts as a mediator between the principals and the agents to ensure that capital is directed to the right objective. The board also performs an important function in the corporate governance framework: it is essentially responsible for monitoring management performance and achieving an adequate return for investors (Ongore and Obonyo, 2011:113).

❖ **Institutional Investors, Stock Markets, and other Intermediaries**

The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance, (OECD, 2015:31).

In order to be effective, the legal and regulatory framework for corporate governance must be developed with a view to the economic reality in which it is to be implemented. In many jurisdictions, the real world of corporate governance and ownership is no longer characterized by a straight and uncompromised relationship between the performance of the company and the income of the ultimate beneficiaries of shareholdings. In reality, the investment chain is often long and complex, with numerous intermediaries that stand between the ultimate beneficiary and the company. The presence of intermediaries acting as independent decision makers influences the incentives and the ability to engage in corporate governance, (OECD, 2015:31).

2.1.10. Characteristics of Corporate Governance

According to (Tarek, 2005:23) Corporate governance is described by a set of characteristics are the cornerstones that missed one, has an effect on thoughtful of its meaning, these characteristics are:

- Discipline: to follow the appropriate and proper ethical conduct .
- Transparency: providing a true picture of what's happening.
- Independence: no unnecessary pressure effects.

- Accountability: the possibility of evaluating and assessing the work of the board of directors and executive management.
- Responsibility: responsibility to all stakeholders in the organization.
- Justice: The necessity of respect the rights of different stakeholder groups.
- Social responsibility: looking at the company as a citizen.

Corporate governance refers to the following characteristics that can be summarized in the following figure:

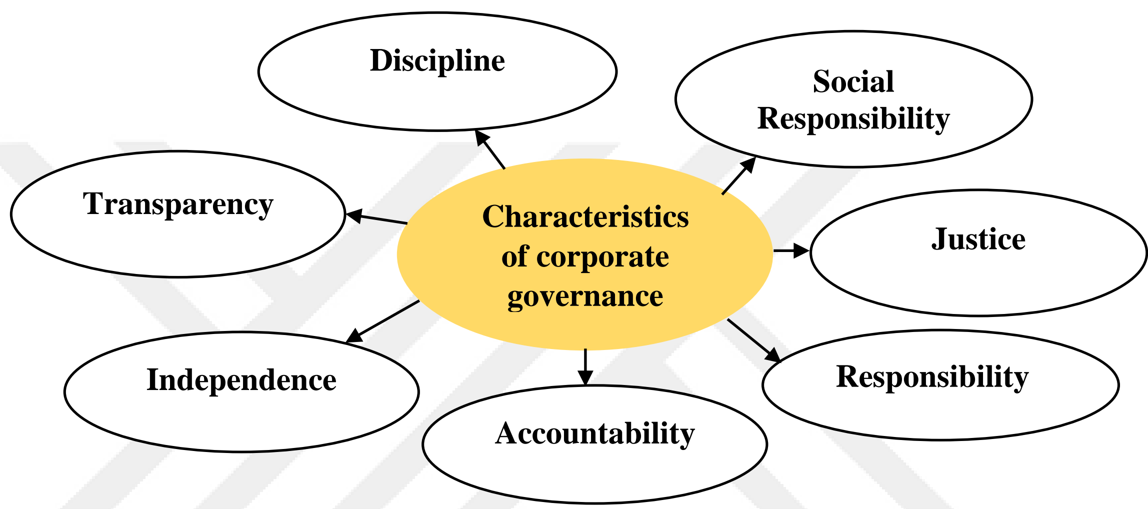

Figure 2.4: The characteristics of corporate governance

Source: Tarek, Abdelal .H. (2005). Corporate governance (concepts, principles, examinations of governance applications in banks) University press, Egypt, Alexandria, p. 23.

2.1.11. Trends in Corporate Governance

Hitt, Ireland, and Hoskisson, (2007) identifying the trends in corporate governance as the following:

- Boards shaping corporation (the bank) strategy.
- Institutional investors, such as pension funds, are becoming active on boards and are putting increasing pressure on top management to improve corporate (the bank) performance.
- Shareholders are demanding that directors and top management own significant stock.

- The stock is increasingly being used as part of a director’s compensation.
- More involvement of non-affiliated outside directors.
- Increased representation of women and minorities.
- Boards evaluating individual directors.
- Smaller boards.
- Splitting the Chairman and CEO positions.
- Shareholders may begin to nominate board members.
- Society expects boards to balance profitability with social needs of society, (Hitt et al, 2007:329).

2.2. Financial Performance

2.2.1. Introduction

Financial performance of commercial banks discusses the act of performing financial activity within the banks. In wider sense, financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the results of a bank's financial policies and operations in monetary terms. It is used to measure commercial bank's overall financial health over a given period of time and can also be used to compare similar banks across the same industry or to compare industries or sectors in aggregation.

2.2.2. Definitions of Financial Performance

Performance may be defined as the reflection of the way in which the resources of a company (bank) are used in the form which enables it to achieve its objectives. According to (Heremans, 2007:6) Commercial banks financial performance is the employment of financial indicators to measure the extent of objective achievement, contribution to making available financial resources and support of the bank with investment opportunities.

While Rutagi, (1997) defines financial performance as to how well an organization is performing. Other researchers define financial performance of the organization or the bank as the extent to which an organization achieves its intended outcome (Namisi, 2002:44).

2.2.3. The Measurements of Financial Performance

The measurement of bank’s financial performance, particularly commercial banks is well researched and has acknowledged increased attention over the past years. Accordingly, there have been also a large number of empirical studies on commercial banks’ financial performance around the world, despite the fact there have been little done on financial performance of commercial banks in Iraq and Kurdistan Region, Erbil in particular. Given that this current study seeks to examine the role of corporate governance in controlling the financial performance, there is a need for measures that can be used to compare commercial bank’s financial performance across banking sector and over time.

Hence, following Jaworski and Kohli (1996), and Eberl and Schwaiger (2005), measured financial performance. As a result, the same three measures of financial performance used. Of the three measures, return on assets (ROA) and return on equity (ROE) provide accounting measures of performance (Hammond and Slocum, 1996), while price to earnings ratio (PER) reflects “anticipated future earnings as it represents the amount an investor is willing to pay now for one dollar of earnings in the future” (Sobol and Farelly 1988:47).

2.2.3.1. Return on Assets (ROA)

ROA provides a measure for assessing the overall efficiency with which farm (bank) assets are used to produce net income from operations. It also is indicative of management’s effectiveness in deploying capital, because it is certainly possible to be efficient and yet poorly positioned in terms of how capital is being utilized, (Miller et al, 2001:5).

McGuire et al. (1990) examined the relationship between firm reputation and both previous and future financial performance using a sample of the ten largest firms from 31 US industries. While the authors use a short-term, yet longitudinal approach to assess financial performance, reputation was measured only once, specifically, the 1983 Fortune AMAC ratings. Previous financial performance (1977- 1981) was calculated by averaging the result across those years for a range of separate accounting measures including ROA, sales growth and asset growth. Put simply, ROA was averaged over a six-year period to obtain an average measure of ROA, as was sales growth and asset growth.

According to (Hutchinson and Gul 2004:605) and (Mashayekhi and Bazazb 2008:164), accounting-based performance measures present the management actions outcome and are hence preferred over market-based measures when the relationship between corporate governance and firm performance is investigated. As a result, a company showing a positive performance through ROA, it indicates its achievement of prior planned high performance (Nuryanah and Islam, 2011:26). The measurement is such that the higher the ROA, the effective is the use of assets to the advantage of shareholders (Haniffa and Huduib, 2006:1043). Higher ROA also reflects the company's effective use of its assets in serving the economic interests of its shareholders (Ibrahim and AbdulSamad, 2011:107).

The variable return on assets (ROA) is defined as net profit divided by total assets. This ratio is a measure of profitability commonly used and has been used by many authors (Ayadi and Boujelbene, 2012).

The return on assets expressed in general economic profitability. Its advantage is that it covers all activities of the bank. Its disadvantage is that it places all of the assets on the same level of risk as the risks associated with components of the total assets are different. In addition, it neglects the off-balance sheet activities are being scaled up in banking (Demsetz and Saidenberg, 1999). Return on assets is an indicator of how profit a company is or how efficient is the management as using its assets to generate earning, and is sometimes referred to as Return on Investment. It is calculated by dividing a company net income by its total assets:

Return on Assets (ROA) = (Net Income) / (Total Assets). (Marashdeh, 2014:100).

2.2.3.2. Return on Equity (ROE)

ROE is also a very useful measure of the performance of the farm owners' invested or equity capital. Farmers generally have other alternatives to investing in the farm operation and need a basis for comparing the likely performance of investments in the farm to their investment alternatives. ROE is not a risk-adjusted return measure. So ROE should be adjusted for differences in the perceived riskiness of alternative investments when making head-to-head comparisons. Because farming entails significant amounts of financial risk, ROE should be higher than a relatively less risky alternative such as a longer term certificate of deposit. ROE is related to and heavily influenced by ROA.

Increasing ROA by taking management action that will either increase operating profit margin and/or asset turnover should have a favorable impact on ROE. (Miller et al, 2001:5).

Return on equity (ROE), return on capital employed (ROCE) or restrictive use of25 market based measures (such as market value of equities) could also contribute to this inconsistency (Gani and Jermias, 2006).

Although an important and relevant information about bank's financial performance can be provided by accounting and financial ratios, assessing the relationship among many factors that are related to bank performance such as assets, revenue, profit, market value, number of employees, investments, and customer satisfaction can assist in improving bank productivity (Seiford and Zhu, 1999:12).

The variable return on equity (ROE) is defined as net profit divided by book value of equity. This ratio is a measure of financial profitability or the rate of return on shareholders. It has been used by many authors (Brown and Marcus, 2009:132). It measures the efficiency with which the bank uses equity entrusted by shareholders. The disadvantage of this ratio is that it can give a biased picture of profitability since a high ratio may be from a low level of equity. From the point of view of the shareholders, return on equity is considered to be the most important ratio to measure the firm performance because it focuses on the return of the shareholders (Demsetz and Lehn, 1985). Return on Equity measures the profit of the company by revealing how much profit the company generates regarding to the amount of the money invested by the investor. It is calculated by dividing a company net income by its total equity. It is also known as Return on Net Worth:

Return on Equity (ROE) = (Net Income) / (Total Equity). (Marashdeh, 2014:100).

Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. It is calculated through the following formula:

Return on Equity = Net Income / Shareholder's Equity. (Fred, 2012:37).

Return on Equity (ROE) - measures a firm’s financial performance by revealing how much profit a company generates with the money shareholders

have invested. It shows how well the shareholders' funds are managed and used to generate return.

ROE = Profit after Tax / Total Equity. (Fred, 2012:44).

Return on Equity shows on how the bank management effectively handles the shareholders' funds to generate profits. There is a preference to a high return on equity for it shows the management is efficient in managing the shareholders' funds to generate revenues. A study AL Khalayleh (2001:34) in the relationship between accounting performance indicators for Jordanian firms showed a positive relationship between the market power per share and the return on equity ratio.

2.2.3.3. Return on Investment (ROI)

Return on investment (ROI) is a measure that investigates the amount of additional profits produced due to a certain investment. Businesses use this calculation to compare different scenarios for investments to see which would produce the greatest profit and benefit for the company (Botchkarev and Andru, 2011:253). There are many motives for exploring ROI. These motives relate not only to how an organization is perceived by others but what it knows about itself (ESRI, 2013). This self – examination encourages improvements in process that keep business profitable and government organization effective (ibid). Regarding to the previous studies ROI can be calculated by using the following formula:

ROI= (Gain from Investment – Cost of investment) / Cost of Investment) * 100%

The acceptance of ROI related to many objective and subjective motives (Botchkarev and Andru, 2011:254):

- Anecdotal evidence of successful use.
- Easy to understand and straightforward.
- Easy to compute.
- Encourages prudent detailed financial analysis
- Encourages cost efficiency and focuses on one of the main corporate metrics – profitability.
- Being based on the accounting records provides objective outputs.
- Data used is available in the accounting system or official documentation.

- Permits comparisons of profitability of dissimilar businesses/projects.
- Promotes accountability. Transparent collection and use of official financial data contributes to responsible behaviors of those involved in data collection and evaluations.
- Encourages project teams and finance/accounting practitioners to collaborate.

Subjective motives for traditional ROI popularity:

- Seems familiar from college textbooks.
- Feels familiar from personal investment experience.
- Seemingly easy to collect and process data.
- Use of data and math makes creates anticipation of an accurate and definitive result.
- Single number result – simplifying for the mind.
- Provides quantifiable evidence of value.
- Single measure offers a seemingly global evaluation of performance.

Based on the above, it is clear the ROI considered as one of basic performance measurements for any organization because of many subjective and objective motivates, thus ROI add in this study as one of performance measurement.

2.2.3.4. Operating Profit Margin (OPM)

The rate of return on assets may be calculated by multiplying the operating profit margin ratio (OPM) times the asset turnover ratio (ATR). The interrelatedness of these three performance measures emphasizes the fact that there are two primary ways to enhance the efficient use of farm resources to produce profit. One is to increase the profit per unit of output. Operating profit margin is a measure of profit per unit (dollar) of product produced or output. It is calculated by dividing the dollar amount of return on assets by gross farm revenues. A farm operation that has a high operating profit margin percentage is a low cost producer. Thus, the general manager may respond to a poor or small operating profit margin by instituting cost controls in order to increase profits per unit, (Miller et al, 2001:5).

Many of previous studies concern on Profit Margin (PG) as a financial measurement for organizations (Aljaboury, 2007:264). (Saeed and Jameel, 2007:98) revealed that PC considered as one of the most important financial performance for banks in Iraq. PG can be calculated by the following formula:

PG = (income – Cost of sales) / income.

Finally, in this study will concern on PG, ROI, and as financial performance measurements because these measurements are the most common measurements and also can be applicable in Kurdistan Region. Paul (2001) carried out a study on evidence on mergers and acquisitions and asserts that a second approach to measuring merger effects is by evaluating the data from financial statements. This is done before and after the merger or acquisition in order to know what happened after the merger or acquisition. The study focuses on profit margins, cash flow statements, accounting rate of return among others.

2.2.4. Financial Performance of Commercial Banks

Most studies divide the determinants of commercial banks' financial performance into two categories, namely internal and external factors. Internal determinants of profitability, which are within the control of bank management, can be broadly classified into two categories, i.e. financial statement variables and nonfinancial statement variables, (Linyiru, 2006: 34).

While financial statement variables relate to the decisions which directly involve items in the balance sheet and income statement; non-financial statement variables involve factors that have no direct relation to the financial statements, (Sudin, 2004). The examples of non-financial variables within the this category are number of branches, status of the branch (e.g. limited or full-service branch, unit branch or multiple branches), location and size of the bank. According to Sudin, (2004) the external factors are those factors that are considered to be beyond the control of the management of a bank. Among the widely discussed external variables are competition, regulation, concentration, and market share, and ownership, scarcity of capital, money supply, inflation and size, (Ogumu, 2006:26).

Consequently, the literature related to commercial banks' financial performance suggests that there are two main approaches to measuring financial performance (Eberl and Schwaiger, 2005). Firstly, there is what has been termed a 'subjective' view that "draws on the perception of financial performance in the eyes of various stakeholders" (Eberl and Schwaiger, 2005, 843). Secondly, there is the 'objective' view that relies on objective measures of financial performance generally reported by the company itself (Reinartz, Kraft and Hoyer, 2004).

Samad (2004) examines empirically the performance of Bahrain's commercial banks with respect to credit (loan), liquidity and profitability during the period 1994-2001. Ten financial ratios are selected for measuring credit, liquidity and profitability performances. By applying t-test to these financial measures, his paper finds that commercial banks' liquidity performance is not at par with the banking industry. Commercial banks are relatively less profitable and less liquid and, are exposed to risk as compared to banking industry. With regard to credit performance this study finds no unambiguous conclusion.

Tarawneh (2006) found that the banks having high total capital, deposits, credits, or total assets does not always means that has healthier profitability performance. The operational efficiency and asset management, in adding to the bank size, positively influenced the financial performance of these banks. In the light of his empirical study he concluded that the operational efficiency and asset management, in addition to the bank size, strongly and positively influenced financial performance of the banks.

Kumbirai, and Webb (2010) investigated the performance of South Africa's commercial banking sector for the period 2005- 2009. Financial ratios are employed to measure the profitability, liquidity and credit quality performance of five large South African based commercial banks. The study found that overall bank performance increased considerably in the first two years of the analysis. A significant change in trend is noticed at the onset of the global financial crisis in 2007, reaching its peak during 2008-2009. This resulted in falling profitability, low liquidity and deteriorating credit quality in the South African Banking sector.

2.2.5. The Relationship between Corporate Governance and Financial Performance

There were varied results concluded by previous studies pertaining to the relationship between corporate governance and financial performance. The important empirical studies are summarized below in this section:

Abu-Tapanjeh (2006) analyze the relationship between corporate governance mechanism and firms' operating and financial performance by employing multiple regression models with panel data set based on 39 industrial companies listed in Amman Stock Exchange of Jordan, over the period of 1992 to 2004. The proportion of outside directors, family member on board, general manager duality, gear ratio and firm size was the independent variables of the study whereas the net sales to operating cost ratio and dividend payout ratio were used as a measure of firms' operating and financial performance, respectively. The results showed that proportion of outside directors, general manager duality and firm size positively and significantly influences firms' performance both operating and financial. Moreover, gear ratio had significant positive influence on operating performance but insignificant in case of financial performance. On the other hand, family members on board have not significant effect on firms' operating as well as financial performance.

Bathula (2008) studied the association between board characteristics and firm performance. Board characteristics which were considered in the research include board size, director ownership, chief executive officer duality, gender diversity, educational qualification of board members and number of board meetings. Additionally, firm age and firm size was used as control variables. Firm performance was measured by return on assets. To test the hypothesis a sample of 156 firms over a four year period data from 2004 to 2007 was used. The sample includes all firms listed on New Zealand stock exchange. Empirical analysis was undertaken using Generalized Least Squares analyses. The findings of the study showed that board characteristics such as board size, chief executive officer duality and gender diversity were positively related with firm performance, whereas director ownership, board meetings and the number of board members

with PhD level education was found to be negatively related. Firm age and firm size does not have significant influence.

Babatunde and Olaniran (2009) analyze the effects of internal and external governance mechanism on performance of corporate firms in Nigeria. In the study panel data regression analysis was used with a sample of 62 firms listed on the Nigerian Stock Exchange for a period of five years from 2002 to 2006 to examine the relationship between internal and external governance mechanisms and corporate firms' performance. The researchers found a positive and significant relationship between board size, block shareholders and leverage and the dependent variable Tobin's Q. However, the study revealed an inverse relationship between director's shareholdings, firm size, independence of the audit committee and the numbers of outside directors on board. When the return on asset was used as the dependent variable significant positive relationship of board size, block holders and leverage with return on asset was found. However, there was a negative relationship between the number of outside directors on board, director's shareholdings, independence of the audit committee, firm size and the return on asset. In addition, the study found that the measure of performance matter for analysis of corporate governance studies. In some cases different result were obtained based on the measure used.

Ibrahim et al. (2010) examined the role of corporate governance in firm performance. Their study was a comparative analysis between chemical and pharmaceutical sectors of Pakistan using a sample of five companies from each sector from the year 2005 to 2009. Multiple linear regression models with panel data methodology were used. Return on asset and return on equity was used as a measure of performance and they used three corporate governance variables; board size, board independence and ownership concentration. They found that in both sectors, the impact of corporate governance on return on equity is significant but there is no significant impact on return on asset. In case of sector wise analysis, there is an insignificant impact of corporate governance on return on asset for chemical and pharmaceutical. On the other hand, there is a significant impact of corporate governance on return on equity in chemical sector, but in pharmaceutical the impact is insignificant.

Amran. (2011) empirically studied the association between Corporate Governance Mechanisms and Company Performances. It was expected that corporate governance mechanisms affect company performance. The hypothesis was tested on 424 public listed Malaysian Companies (233 family controlled firms and 191 non-family controlled firms) and the data about corporate governance mechanisms and company's performance was collected from Sultanah Bahiyah Library database from the year 2003 to 2007. Board size, board independence, director's qualification, director's professional qualification, leadership structure were used as a corporate governance mechanisms, debt, firm age and firm size were used as a control variable while Tobin's Q were used as a measure of company performance.

Panel data methodology with generalized least square estimation method was used to test the hypothesis. The analysis has been done by classifying the sample as family controlled firm and non-family controlled firm. The researcher revealed that director's qualification measured as the percentage of directors with degree and above divided by total directors helps to enhance the performance of non-family controlled firms but insignificant for family controlled firms. Board size and leadership duality was a significant negative influence on family controlled firms performance but insignificant for non-family controlled firms. Firm age was a significant negative and positive association between the performance of family controlled and non-family controlled firms respectively. On the other hand, there was a significant negative relationship between firm size and performance of both family controlled and non-family controlled firms. The other variables such as board independence and director's professional qualification were insignificant for both classes of firms.

Khatab et al. (2011) investigated the relationship between corporate governance and firms' performance the case of twenty firms listed at Karachi Stock Exchange. The researchers' used Pooled Ordinary Least Square estimation method with panel data set that covers five years period from the year 2005 to 2009, with a sample of twenty firms. Tobin's Q, return on asset and return on equity were the dependent variables of the study and firm size, leverage and growth were the independent variables of the study. The study revealed that

leverage and growth has positive and significant impact on Tobin's Q and return on asset. Like Tobin's Q and return on asset leverage positively and significantly influence return on equity. However, growth has a negative and significant impact on return on equity. Size of the firms has remained insignificant. The researchers' recommended to extend the study period, increase simple size and to include more profitability ratios for further study.

Adusei (2011) investigated the relationship between board structure and bank performance with panel data from the banking industry in Ghana by implementing estimation method of regression is pooled OLS. A total sample of 17 out of 26 universal banks was used in the study in this study. The researcher used return on asset and cost income ratio as dependent variable of the study and board size and board independence as independent variable of the study. In addition to this the researcher incorporated bank age, bank size, funds, and ownership structure and listing status as a control variable of this study. The study found that as the size of a bank's board of directors decreases its profitability increases. In addition to this board independence has a negative, but statistically insignificant correlation with bank profitability. No significant relationship between the size of a bank and its financial performance has been found. He recommended that banks seeking some improvement in their performance should constitute small sized boards of directors composed of few independent directors.

Al-Hawary. (2011) examined the effect of banks governance on banking performance by taking all Jordanian commercial banks listed in Amman Stock Exchange i.e. 13 banks. The researcher employed multiple regression models to measure the influence of corporate governance variables on banks performance by controlling bank's size. According to the study executive officer duality and percentage of non-executive directors had statistically significant positive effect on Tobin's Q. whereas leverage value had statistically significant negative effect on Tobin's Q, and capital adequacy, size of board of directors, the largest shareholder, block holders' equity ratio and bank's size had no statistically significant effect on Tobin's Q.

Al-Manaseer et al. (2012) empirically investigated the impact of corporate governance on performance using 15 Jordanian banks listed at Amman Stock Exchange from the year 2007 to 2009 with a total of 45 bank-year observation. The study employed pooled data, and OLS estimation method with panel methodology. Return on asset, return on equity, profit margin (measured as net interest income divided by total asset) and earning per share were the dependent variables of the study and board size, board composition (independence), chief executive officer status, foreign ownership and bank size were the independent variables of the study. The study revealed a significant negative relation between board size and banks performance as measured by return on equity and earning per share but insignificant negative association of board size with return on asset and profit margin was found. Bank size was negatively related with return on asset, return on equity and profit margin but only significant with profit margin. The study also reveals a positive association between board composition and foreign ownership and bank performance. In addition, chief executive officer status has a negative influence. Finally, the researchers suggest extending the study period.

Finally, as far as the researcher's knowledge concerned there is no research that has been conducted to provide empirical evidence particularly on the impact of corporate governance mechanisms on financial performance of commercial banks in Erbil Iraq. Given this lack of empirical studies, this study fills the gap and provides empirical evidence on the impact of corporate governance mechanisms on financial performance of selected commercial banks in Erbil by taking in to consideration the variables related to the realities of the commercial banks governance mechanism in Erbil.

CHAPTER THREE
METHODOLOGY OF THE STUDY

3.1. Introduction

The purpose of this chapter is to discuss and substantiate the methodological processes applied in this study in order to examine the role of corporate governance in controlling financial performance of commercial banks operating in Erbil City and to respond to the study questions and the hypotheses. Accordingly, the chapter argues the study design, the description of the study population, the sampling procedures, and data collection procedures, data collection instrument, data analysis and the limitation of the study.

3.2. Study Approach

This study employs a quantitative approach. A quantitative approach is reflected suitable as the purpose of the study is to examine the role of corporate governance in controlling financial performance, from a statistical viewpoint regarding the commercial banks operating in Erbil.

In addition, a quantitative approach is commonly applied in the study when working with statistical data. Hence, a quantitative research commonly involves numbers and statistical measures that help explain, describe, explore and illustrate relations among variables. Furthermore, the quantitative study can be seen as a study method that through statistical and quantified results that are based on the reality tries to measure objectives in order to produce generalizable information.

3.3. Study Design

In order to examine the corporate governance and its role in controlling financial performance of commercial banks operating in Erbil, the study design to develop the relationship and effects among the key study variables, namely, corporate governance and financial performance. The design was more applicable as it allowed respondents to give their relevant information on the issue of interest to the study, through survey questionnaire which was used five Likert scale which was more suitable for data collection for this study.

3.4. Study Population

The population for this study included (36) banks operating in Erbil city. Hence, the commercial banks were selected as the population of the study, as they are more possible to better recollection on corporate governance and financial performance, as they have knowledgeable on the corporate governance application . In addition, the commercial banks are the exact targeted population size, this study seeks to explore their manager's attitudes and opinions on their corporate governance practice and financial performance, so they can provide the requested data and information to support the study purpose and answer its questions. Moreover, these banks represent the banks in all Kurdistan Region. From the above discussions it's clear that these three reasons justifies the selection of the population of the study. Therefore, the data was successfully collected from (24) out of the (36) banks; a response rate (66.6%) which is reflect a good point of view for the study.

3.5. Study Sampling

In this fragment the sampling process for this study is presented as well as the sampling structure. The purpose of sampling procedures is, by deploying a variety of methods, to narrow down a study population to classify a suitable sample where the related data needed is accessible and for it to be as suitable or targeted as possible to satisfy the study's purpose.

Hence, the data were taken from commercial banks operating in Erbil city, particularly those serves in financial sector over one year, also commercial banks that deal with both trade and commercial customers were selected. Subsequently, only the managers in commercial banks located in Erbil city were selected to participate in the study, So (125) managers participated through responding to the questionnaire statements which were self-administered and distributed in the banks departments in particular, to the managers who willingly accepted the invitation to participate in the study, accordingly the response rate was (95.2%).

However, only six of the paper questionnaire were invalid and were excluded from the sample. So, the total valid questionnaires were (119), which establishes the sample of the study (Appendix-2) is illustrated the study population and its sample.

3.6. Data Collection Procedures

3.6.1. Secondary Data

Where the Researcher turned to address the theoretical framework, for study secondary sources, which are in the books, References relevant research, Previous studies on the subject and Reading on various internet sites.

3.6.2. Primary Data

To address the analytical aspects of the study topic, the researcher collected the primary data through conducting a survey. In order to applied this survey, a questionnaire was been developed depending on the previous literature. The developed questionnaire considered as a key data collection instrument to study, since this was specifically designed for this purpose and distributed to managers in the commercial banks.

3.7. Data Collection Instrument

A self-designed questionnaire, based on the literature was developed by the researcher and was used to measure the key variables in the study and to collect data from the sample population. The study chose the survey questionnaire as an instrument for collecting data because of its relevance for the study approach and design and for the potential benefits it provides.

A large amount of data it offers in a relatively non-costing and quick way makes it a practical and convenient approach for the study. In addition, when the questionnaire survey is conducted in a standardized and objective manner, more confidence is added in generalizing the findings.

3.7.1. Description of Instrument

The questionnaire was divided into three sections. Each section of the questionnaire contained questions and items that could measure the paradigms and variables stated in the questions and hypotheses of the study. The description of each one of the sections is presented in the next paragraphs and table (3.1) illustrate the questionnaire structure.

Table 3.1: The questionnaire structure

Major Variables	Sub- Variables Components	No of Statements	Scale Symbol
First: Demographical Variables (General Information)	Gender, Age, Level of education, Experience and Scientific specialization	5	
Second: Corporate Governance	Board of Directors	4	X1-X4
	Internal Audit	4	X5-X8
	External Audit	4	X9-X12
	Disclosure and Transparency	4	X13-X16
	The Audit Committees	6	X17-X22
	Accountability	4	X23-X26
Third: Financial Performance	Ten Questions	10	Y1-Y10

The first section, titled "Background information", this was the first section of the questionnaire which included demographic characteristics of gender, age, educational level, experience and scientific specialization. While section two named "Aims to pursue corporate governance", the second section of the questionnaire was about the Scale of Corporate Governance. This section is based on an extensive scale that includes a combination of six components: Board of directors, internal control system, the external audit, transparency and disclosure, accountability and accounting control, and audit committees. Section therefrom the questionnaire, entitled "Evaluation of Financial Performance", this part is based on a comprehensive scale that includes a combination of ten questions (statements), appendix (1) illustrate the survey questionnaire form.

3.8 Reliability and Validity Tests

It is significantly essential that the instrument used for collecting data can provide valid and reliable data that can generate accurate and dependable findings after analyzing. Hence, the questionnaire reliability and validity were checked to assure the quality of the generated data.

3.8.1. Reliability

It means that scores from an instrument are stable and consistent. The scores should be nearly the same when researchers administer the instrument multiple times to the same participants (Plano and Creswell, 2015: 242). One of the most used reliability techniques in the researchs is Cronbach's alpha test for internal consistency. The Cronbach's alpha score for the questionnaire was (.901), which indicated a high level of internal consistency in the whole set of items of the questionnaire. Consequently, the questionnaire used to collect could be considered highly reliable.

Table 3.2: Reliability Statistics

Cronbach's Alpha	N of Items	N	%
.901	36	119	100.0

3.8.2. Validity:

First of all, the term of validity refers to the scores from an instrument are precise indicators of the variable being measured and enable the researcher to draw good explanations (Plano and Creswell, 2015: 242). The validity of the questionnaire was checked through a variety of ways.

Worth mentioning that nearly all of the items in the questionnaire were adapted from similar studies that were already validity checked, but since some of the items were changed or rearranged the researcher checked the validity of the questionnaire through making it checked and assessed by experts which are called content or face validity.

3.8.3. Internal Validity

Internal validity is also linked to the credibility of the study but differs in that it is more focused on the researcher's observation and if the dependent variables vary because of the independent variable and not because of some other variable (Gay, 1992:122). The measures also need to be consistent in order to create a valid result throughout the study (Saunders et al., 2009:46). In this study,

the dependent variable financial performance was calculated and controlled before entered to the data spreadsheet. Regarding significance in relationships between variables, scholars traditionally test relationships and consider those producing a P-value below 0.05 to be significant, The Tables (3.3) and (3.4) showed the correlations between variables components.

Table 3.3: The Internal validity of Corporate Governance Components

			X1	X2	X3	X4	X5	X6
Spearman's rho	Board of directors	Correlation Coefficient	1.000	.484**	.475**	.597**	.411**	.328**
		Sig. (2-tailed)	.	.000	.000	.000	.000	.000
		N	119	119	119	119	119	119
	Internal Audit	Correlation Coefficient			.563**	.561**	.617**	.462**
		Sig. (2-tailed)			.000	.000	.000	.000
		N			119	119	119	119
	External Audit	Correlation Coefficient			1.000	.610**	.563**	.428**
		Sig. (2-tailed)			.	.000	.000	.000
		N			119	119	119	119
	Transparency and Disclosure	Correlation Coefficient				1.000	.521**	.536**
		Sig. (2-tailed)				.	.000	.000
		N				119	119	119
	Audit Committees	Correlation Coefficient					1.000	.520**
		Sig. (2-tailed)					.	.000
		N					119	119
	Accountability	Correlation Coefficient						1.000
		Sig. (2-tailed)						.
		N						119

**. *Correlation is significant at the 0.01 level (2-tailed).*

Table 3.4: The Internal validity of Financial Performance

			Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Spearman's rho	Y1	Correlation Coefficient	1.000	.287**	.525**	.525**	.266**	.264**	.407**	.279**	.229*	.224*
		Sig. (2-tailed)		.002	.000	.000	.004	.004	.000	.002	.012	.014
	Y2	Correlation Coefficient		1.000	.333**	.357**	.312**	.312**	.250**	.198*	.258**	.301**
		Sig. (2-tailed)			.000	.000	.001	.001	.006	.031	.005	.001
	Y3	Correlation Coefficient			1.000	.505**	.454**	.360**	.447**	.412**	.375**	.164
		Sig. (2-tailed)				.000	.000	.000	.000	.000	.000	.074
	Y4	Correlation Coefficient				1.000	.507**	.433**	.467**	.409**	.364**	.180*
		Sig. (2-tailed)					.000	.000	.000	.000	.000	.050
	Y5	Correlation Coefficient					1.000	.421**	.448**	.297**	.332**	.326**
		Sig. (2-tailed)						.000	.000	.001	.000	.000
	Y6	Correlation Coefficient							.447**	.451**	.249**	.519**
		Sig. (2-tailed)							.000	.000	.006	.000
	Y7	Correlation Coefficient							1.000	.472**	.453**	.420**
		Sig. (2-tailed)								.000	.000	.000
	Y8	Correlation Coefficient								1.000	.474**	.542**
		Sig. (2-tailed)									.000	.000
	Y9	Correlation Coefficient									1.000	.408**
		Sig. (2-tailed)										.000
	Y10	Correlation Coefficient										1.000
		Sig. (2-tailed)										

***. Correlation is significant at the 0.01 level (2-tailed).*

**. Correlation is significant at the 0.05 level (2-tailed).*

c. Listwise N = 119

From above Tables, that has been presented nearly all the items were significant (0.000), or p-value smaller than ($0 \leq 0.05$), that mean there are a lot of relations between questionnaire items.

3.9. Data Analysis

The independent variable which is corporate governance which is contained the mechanism of CG. Which are: (Board of directors, internal control system, the external audit, transparency and disclosure, accountability and accounting control, and audit committees). Financial performance as the dependent variable was measured in terms of the combination of ten questions on return on equity in the

last three years, return on assets in the last three years, return on the owner equity, return on investment compared to the previous three years, and the profit margin of operations. The descriptive statistics was used to quantitatively describe the important features of the variables using mean, standard deviations, and t-tests.

The correlation analysis was used to identify the relationship among the independent, dependent variables using spearman correlation analysis. The correlation analysis shows only the degree of relationship between variables and does not permit the researcher to make underlying inferences regarding the relationship between variables.

Therefore, multiple linear regression analysis was also used to test the hypothesis and to explain the relationship between corporate governance variables and financial performance measures by controlling the influence of some selected variables. SPSS V-22 software was used for analysis and the results were presented using tables.

3.10. The limitation of the Study

The study is outlined via spatial, temporal, and human limitations as follows: Frist, the spatial limitations, the study statements has been applied on a sample of commercial banks operating solely within Erbil city in the Kurdistan region of Iraq.

Second, time limitations: represented by the duration of the study applied to the commercial banks in questions, which started via preliminary visits to identify the study questions and interviewing the managers to discuss their opinions and suggestions regarding the study and its objectives, besides distributing the questionnaires and then return them back. Finally, the human limitations: that include human boundaries to look at the managers of a sample of commercial banks in Erbil city, in the Kurdistan region of Iraq.

CHAPTER FOUR
DATA ANALYSIS AND RESULTS

4.1. Introduction

This chapter launches with a descriptive statistics for the demographic information collected from the respondents. The demographic information includes frequency distributions and descriptive statistics. Then at the second section statistical results from the data analysis are presented.

4.2. Description Analysis of Demographic Information

Demographic data included in the investigation were collected and analyzed to provide a solid representation of the sample in the study. The following demographic information was collected: Gender, Age, and Level of education, Experience and Scientific specialization from Managers at commercial banks operating in Erbil. In order to explore the sample and to obtain more information about it and its alignment, the study applied descriptive analysis to achieve this purpose.

As indicated in table 4.1, there were male administrators constituted 51.3 % or (61) individuals of the sample compared to 48.7 % or (58) individuals' female administrators.

Table 4.1: Distribution of the sample according to gender

Group of Gender		Frequency	Percent
Valid	Male	61	51.3
	Female	58	48.7
	Total	**119**	**100.0**

Table 4.2 summarizes the participant's ages, 42.9 % were aged between 20-29 years old, 37 % were aged 30-39 years old; 16 % were age between 40-49 years old; while 2.5 % were age between 50-59. And also 1.7% of the total sample were aged 60 and more years old.

Table 4.2: Distribution of the sample according to age

Group of Ages		Frequency	Percent
Valid	20-29	51	42.9
	30-39	44	37.0
	40-49	19	16.0
	50-59	3	2.5
	60 and above	2	1.7
	Total	**119**	**100.0**

As summarized in table 4.3, the distribution of the respondents according to their level of education, it was displayed that of the total respondents: 81.5 % were Bachelor Degree; 10.9% Higher Diploma; as well as 7.6 % of the respondents were Master Degree holders.

Table 4.3: Distribution of the sample according to level of education

Group of level of education		Frequency	Percent
Valid	Bachelor	97	81.5
	Higher Diploma	13	10.9
	Master Degree	9	7.6
	Total	**119**	**100.0**

As designated in the table 4.4, the respondents overall job experience, it was presented that of the total respondents: 47.9 % were between 5-10 years' experience which was the maximum working experience, while the lowest 3.4 % of the group of more than 20 years,

Table 4.4: Distribution of the sample according to working experience

Groups of working experience		Frequency	Percent
Valid	Less than 5 years	41	34.5
	5-10 years	57	47.9
	11-15 years	8	6.7
	16-20 years	9	7.6
	More than 20 years	4	3.4
	Total	**119**	**100.0**

The respondents of the questionnaire were from various scientific specialization, but the majority of the sample were Business Administration and Economics departments as (Accounting, Management, Finance and banking, Economic and Statistics) respectively majored which was the largest frequency of the sample. As they were more approachable knowing the fact that the study was related to their own scientific specialization, see Table 4.5.

Table 4.5: Distribution of the sample according to scientific specialization

Groups of scientific specialization		Frequency	Percent
Valid	**Management**	34	28.6
	Accounting	41	34.5
	Finance and banking	18	15.1
	Economic	10	8.4
	Marketing	1	.8
	Political Science	1	.8
	Statistics	2	1.7
	Engineering	1	.8
	English Language	2	1.7
	Arabic Language	1	.8
	Computer Science	7	5.9
	Law	1	.8
	Total	**119**	**100.0**

4.3. Description of the Study Variables

This section analysis the first main hypothesis “There is an ordinal significance of the study variables and dimensions, depending on the nature of dependency in commercial banks in Erbil city” these established on participants answer were asked to rate the importance of the corporate governance components on five- point Likert Scale. Descriptive statistics were used to compute mean and standard deviation scores of each variable (item) to find the most ordinal significance. A t-test was also used to test the significance of each item as being qualified for analysis.

4.3.1. Description of Corporate Governance Components

4.3.1.1. Description of Board of Directors

It performs from the table (4.6) the overall t-test 73.329, significant (0.000), mean and standard deviation score were (4.04 and .601) respectively, besides 80.8% of the total responses stated that board of directors were important, and 19.2% of the sample did not agree. That the highest frequency is (X_3) “The board of directors exerts sufficient care to preserve the interests of the bank and shareholders' equity through the disclosure of information.”

In regard to severity, the highest severe items are (M= 4.12, SD= 0.865, (0.000) and the least severe is (X_4) “Board of directors enjoys independence from the executive management.” (M= 3.90, SD= 0.986, sig (0.000). It has been also shown that all the items were significant (0.000) or p-value smaller than ($0 \leq 0.05$), and that they are qualified for analysis, the same result of significance goes for all the items in the coming questions which mean that all included items were significant.

Table 4.6: Result of description analysis of the board of directors

Statements	N	Mean	Std. Deviation	t-test	DF	Sig. (2-tailed)
X1	119	4.06	.795	55.690	118	.000
X2	119	4.09	.713	62.615	118	.000
X3	119	4.12	.865	51.910	118	.000
X4	119	3.90	.986	43.125	118	.000
Board of directors	**119**	**4.0420**	**.60130**	**73.329**	**118**	**.000**

4.3.1.2. Description of Internal Audit

From Table (4.7) the general t-test 60.878, significant (0.000), mean and standard deviation (4.09, .734) respectively, 81.8% of the overall responses stated that internal audit was important, although 18.2% stated that this component was not significant on financial performance. The result indicates that (X_5) riches this component “The bank management is provide training courses on internal auditors to inform them about the latest developments in the business.” Where (M= 4.18, SD= 0.908), and the smallest frequent compare to others is (X_7) “Establish the amount of achievement of planned targets and the effectiveness of

the results by the internal audit department.” (M= 4.01, SD= .943). It has been also presented that all the items were significant (0.000), or p-value smaller than ($0 \leq 0.05$).

Table 4.7: Result of description analysis of internal audit

Statements	N	Mean	Std. Deviation	t-test	DF	Sig. (2-tailed)
X5	119	4.18	.908	50.174	118	.000
X6	119	4.15	.908	49.876	118	.000
X7	119	4.01	.943	46.356	118	.000
X8	119	4.06	.837	52.924	118	.000
Internal Audit	119	**4.0987**	**.73446**	**60.878**	118	**.000**

4.3.1.3. Description of External Audit

As it is shown in table (4.8) the aggregate t-test 65.374, significant (0.000) where mean and standard deviation score were (4.11, .686) respectively, although 82.3% of the total responses stated that external audit was important, however, 17.7% stated that this component was not influential on financial performance. The result appearances that (X_9) riches this component “External auditing is done by a party outside the bank to examine the accounting data records.” (M= 4.22, SD= 0.855), and the lowest frequent is (X_{12}) “External auditor in the bank characterized by independence, which helps to do his work efficiently and effectively.” (M= 4.05, SD=0.928). It has been also obtainable that all the items were significant (0.000) or p-value smaller than ($0 \leq 0.05$).

Table 4.8: Result of description analysis of external audit

Statements	N	Mean	Std. Deviation	t-test	DF	Sig. (2-tailed)
X9	119	4.22	.855	53.804	118	.000
X10	119	4.06	.847	52.295	118	.000
X11	119	4.13	.765	58.814	118	.000
X12	119	4.05	.928	47.595	118	.000
External Audit	119	**4.1134**	**.68639**	**65.374**	118	**.000**

4.3.1.4. Description of Disclosure and Transparency

It performs from the table (4.9) the overall t-test 66.076, significant (0.000), mean and standard deviation score were (3.90, .0591) respectively, besides 78.1% of the total answers stated that disclosure and transparency were important, and 21.9% of the sample did not agree. The result showed that (X_{13} and X_{16}) riches this component. It has been also displayed that all the items were significant (0.000), or p-value smaller than ($0 \leq 0.05$).

Table 4.9: Result of description analysis of the disclosure and transparency

Statements	N	Mean	Std. Deviation	t-test	DF	Sig. (2-tailed)
X13	119	3.97	.848	51.111	118	.000
X14	119	3.90	.838	50.780	118	.000
X15	119	3.81	.836	49.647	118	.000
X16	119	3.95	.928	46.410	118	.000
Transparency and Disclosure	119	**3.9076**	**.64511**	**66.076**	118	**.000**

4.3.1.5. Description of the Audit Committees

From Table (4.10) the overall t-test 66.509, significant (0.000), mean and standard deviation (4.04, .663) respectively, 80.9% of the whole responses stated that the audit committees were significant, while 19.1% only quantified that this component was not significant on financial performance. The result showed that (X_{17} and X_{19}) riches this component. It has been also obtainable that all the items were significant (0.000), or p-value smaller than ($0 \leq 0.05$).

Table 4.10: Result of description analysis of the audit committees

Statements	N	Mean	Std. Deviation	t-test	DF	Sig. (2-tailed)
X17	119	4.11	.821	54.585	118	.000
X18	119	4.10	.858	52.162	118	.000
X19	119	4.11	.871	51.448	118	.000
X20	119	4.04	.960	45.922	118	.000
X21	119	4.03	.916	47.957	118	.000
X22	119	3.90	1.012	42.041	118	.000
Audit Committees	119	**4.0476**	**.66389**	**66.509**	118	**.000**

4.3.1.6. Description of Accountability

As it is shown in table (4.11) the collective t-test 65.374, significant (0.000) where mean and standard deviation score were (4.11, and .686) respectively, although 82.3% of the total responses stated that accountability was important, however, 17.7% indicated that this component was not influential on financial performance. The result also showed that (X_{23} and X_{24}) riches this component. It has been also attainable that all the items were significant (0.000) or p-value smaller than ($0 \leq 0.05$).

Table 4.11: Result of description analysis of the audit accountability

Statements	N	Mean	Std. Deviation	t-test	DF	Sig. (2-tailed)
X23	119	4.28	.823	56.722	118	.000
X24	119	4.05	.910	48.559	118	.000
X25	119	4.04	.915	48.190	118	.000
X26	119	4.03	.943	46.566	118	.000
Accountability	119	**4.0987**	**.71768**	**62.301**	118	**.000**

4.3.2. Description of Financial Performance

From Table (4.12) the overall t-test=65.738, significant (0.000) where mean and standard deviation score were (3.89, and .646) respectively, while 77.9% of the total responses stated that financial performance was important.

Thus, according to description analysis scores we can see that the most significant commercial banks financial performance were; first the (Y_6) "The rate of return on the bank's owner equity exceed the competitive banks." as 82.4% of the participants stated that it was significant; Second (Y_9) "Bank has made a positive change in the profit margin of operations compared to the previous three years" as 81% of the participants indicated that it was important. "Bank has had worthy improvement on return on equity in the last three years" was the third significant elements as 80.1 % of the participants agree it was important. It has been also shown that all the items were significant (0.000), or p-value smaller than ($0 \leq 0.05$).

Table 4.12: Result of description analysis of the financial performance

Statements	N	Mean	Std. Deviation	t-test	DF	Sig. (2-tailed)
Y1	119	4.08	.787	56.581	118	.000
Y2	119	3.61	.874	45.080	118	.000
Y3	119	3.75	.805	50.798	118	.000
Y4	119	3.87	.873	48.325	118	.000
Y5	119	3.86	.762	55.196	118	.000
Y6	119	4.12	3.769	11.917	118	.000
Y7	119	3.96	.741	58.269	118	.000
Y8	119	3.87	.791	53.303	118	.000
Y9	119	4.05	.735	60.139	118	.000
Y10	119	3.82	.799	52.215	118	.000
Financial Performance	119	**3.8983**	**.64689**	**65.738**	118	**.000**

The answer of advertising, the board of directors, internal audit, the external audit, transparency and disclosure, audit committees and accountability, explain agreeableness (table 4.13). Hence, it means that all the components of corporate governance will impact on financial performance of the commercial banks in Erbil.

In addition, the variable of the external audit was the most important factor stimulating to impact on financial performance with a rate of 82.2% agreement. On the other hand, transparency and disclosure were the least important factor to financial performance with a rate of 78.1% agreement. Therefore, the first hypotheses could be accepted, which states that there is a rank significance of the study variables and dimensions, depending on the nature of dependency in commercial banks in Erbil city.

Table 4.13: The rank significant results of the study variables

Variables	N	Mean	Rank significant
Board of directors	119	4.0420	**5**
Internal Audit	119	4.0987	**3**
External Audit	119	4.1134	**1**
Transparency and Disclosure	119	3.9076	**7**
Audit Committees	119	4.0476	**4**
Accountability	119	4.0987	**2**
Financial Performance	119	3.8983	**6**

4.4. Hypothesis Testing

4.4.1. Correlation Analysis of the Variables

The table below (4.14) clarifies the result of the analysis carried out to test the second main hypotheses which state that there is a positive relationship between corporate governance and financial performance of commercial banks operating in Erbil city.

To test the relationship between the variables; Spearman's (R=.614**) correlation was calculated. The correlation coefficient for the data revealed that variables tested were positively and significantly correlated.

Table 4.14: Spearman Correlation analysis between Corporate Governance and Financial Performance

			Corporate Governance	Financial Performance
Spearman's rho	**Corporate Governance**	Correlation Coefficient	1.000	.614**
		Sig. (2-tailed)	.	.000
		N	119	119
	Financial Performance	Correlation Coefficient	.614**	1.000
		Sig. (2-tailed)	.000	.
		N	119	119

**. Correlation is significant at the 0.01 level (2-tailed).

In the table (4.15) the correlation matrix explains that the components of the independent variable (board of directors, internal audit, the external audit, transparency and disclosure, audit committees and accountability) were positively correlated with the financial performance of commercial banks. Besides, the table shows that transparency and disclosure achieved the highest positive correlation with financial performance. On the other hand, an external audit has the weakest correlation with financial performance.

In addition, table (4.15) illustrates that board of directors, internal audit, the external audit, transparency and disclosure, audit committees and accountability, have a positive relationship with financial performance at the value of (0.000, 0.000, 0.000, and 0.000) respectively, which they are less than 0.05. Consequently, the second main hypotheses could be accepted on the level of the whole variable and individually (Components).

Table 4.15: Spearman Correlation analysis between Corporate Governance Components and Financial Performance

Variables	Board of Directors	Internal Audit	External Audit	Transparency and Disclosure	Audit Committees	Accountability
Financial Performance	**.479****	**.503****	**.363****	**.533****	**. 484****	**.480****
Sig. (2-tailed)	**.000**	**.000**	**.000**	**.000**	**.000**	**.000**

**. Correlation is significant at the 0.01 level (2-tailed). N=119

4.4.2. Regression Analysis of the Variables

This study conducted a multiple linear regression analysis (MLRA) in order to find out the effect of the corporate governance includes; (board of directors, internal audit, the external audit, transparency and disclosure, audit committees and accountability) in controlling financial performance. The subjects of the study were six components of corporate governance and they represent (0.304) of the financial performance as characterized by the **R Square**. Consequently, this means that other elements not examined in this study contribute to (0.696) of the financial performance, as shown in the table (4.16).

Table 4.16: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.551[a]	.304	.298	.54202

a. Predictors: (Constant), Corporate Governance

The significance value is (sig 0.000) being less than (0.05). Therefore, the model has it is statistical significance in predicting how the board of directors, internal audit, the external audit, transparency and disclosure, audit committees and accountability impacts controlling financial performance. At (0.05) level of significance, the **F** calculated was 51.078, and **DF** (117, 118), which explains that the overall model was significant.

Table 4.17: ANOVA Analysis

Model		Sum of Squares	DF	Mean Square	F	Sig.
1	Regression	15.006	1	15.006	51.078	.000[b]
	Residual	34.373	117	.294		
	Total	49.380	118			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Corporate Governance

The results presented, show that statically there is a significant impact of board of directors, internal audit and external audit on financial performance as explained by a coefficient of (.382, 407 and 363) respectively, and as shown by a p-value of (.000, .000 and .000) respectively. Furthermore, statically there is a significant impact of transparency and disclosure on financial performance as presented by a coefficient of (.506) and a p-value of (.000). The results explain that statically there is a significant impact of Audit Committees on financial performance as demonstrated by a coefficient of (.459) and a p-value of (.000).

Finally, the results explain that statically there is a significant impact of accountability on financial performance as explained by a coefficient of (.441) and a p-value of (.000). Thus, the regression results explain that board of

directors, internal audit, the external audit, transparency and disclosure, audit committees and accountability have all significant impact on financial performance of commercial banks operating in Erbil, and therefore the third hypotheses can be accepted.

Table 4.18: Regression Analysis

Coefficients [a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.237	.376		5.957	.000
	Board of directors	.411	.092	.382	4.471	.000
	Internal Audit	.358	.074	.407	4.814	.000
	External Audit	.342	.081	.363	4.215	.000
	Transparency and Disclosure	.507	.080	.506	6.342	.000
	Audit Committees	.447	.080	.459	5.588	.000
	Accountability	.397	.075	.441	5.311	.000

a. Dependent Variable: Financial Performance

Also in Figure (4.1) the result of Normality test shown that there is normality distribution in study participations answers.

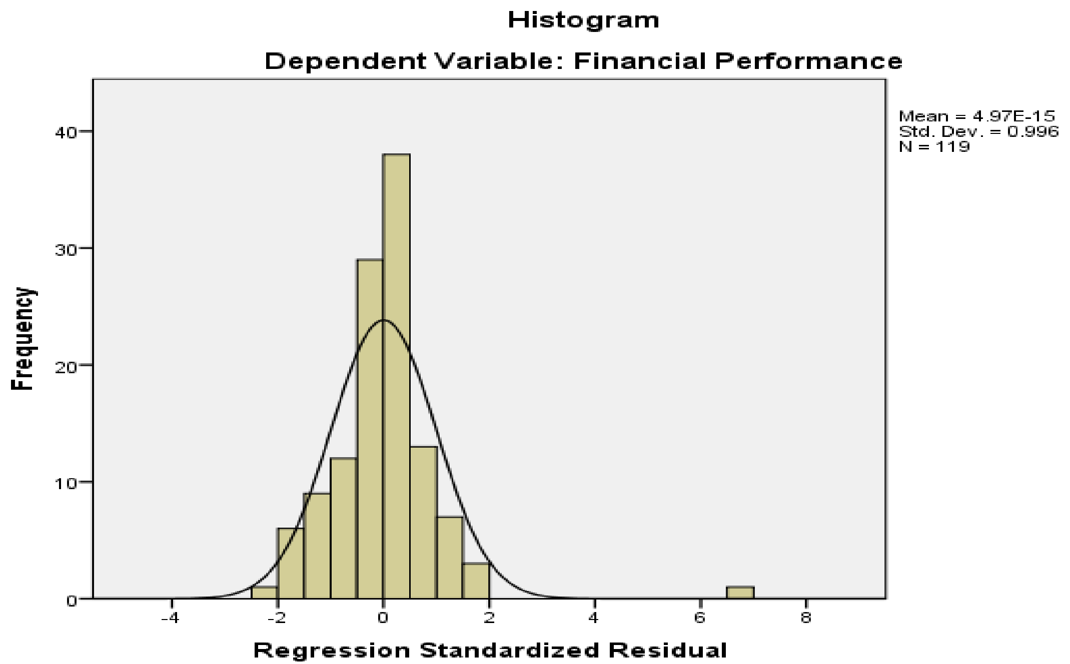

Figure 4.1: Normality test

In addition, Figure (4.2) illustrates the Linearity test results that there is linearity relationship between the independent variable the corporate governance and dependent variable which is financial performance.

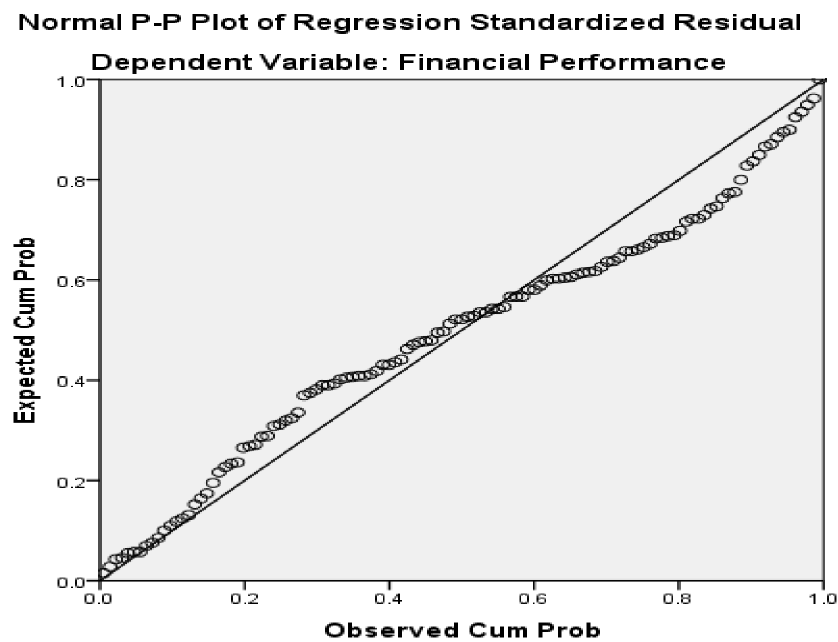

Figure 4.2: Linearity test

4.5. Result of Hypotheses

As showed in the table (4.19) the results of investigated model the role of corporate governance in controlling financial performance of commercial banks operating in Erbil city. And its proposed hypotheses, that all the hypotheses were accepted.

Table 4.19: Result of hypotheses

	Hypotheses	**Result**
H_1	There is a rank significance of the study variables and dimensions, depending on the nature of dependency in commercial banks in Erbil city.	**Accepted**
H_2	There is a positive relationship between corporate governance and financial performance of commercial banks operating in Erbil city.	**Accepted**
$H_{2.1}$	There is a positive relationship between board of directors and financial performance of commercial banks operating in Erbil city.	**Accepted**
$H_{2.2}$	There is a positive relationship between internal audit and financial performance of commercial banks operating in Erbil city.	**Accepted**
$H_{2.3}$	There is a positive relationship between external audit and financial performance of commercial banks operating in Erbil city.	**Accepted**
$H_{2.4}$	There is a positive relationship between transparency and disclosure and financial performance of commercial banks operating in Erbil city.	**Accepted**
$H_{2.5}$	There is a positive relationship between audit committees and financial performance of commercial banks operating in Erbil city.	**Accepted**
$H_{2.6}$	There is a positive relationship between accountability and financial performance of commercial banks operating in Erbil city.	**Accepted**
H_3	There is a statistically significant effect of corporate governance on financial performance of commercial banks operating in Erbil city.	**Accepted**

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1. Conclusions

The purpose of this study was to examine the role of corporate governance in controlling financial performance of commercial banks in Erbil. Therefore, the study examined the relationship between corporate governance and financial performance by taking indication from selected commercial banks in Erbil, as well as examined the effect of corporate governance on the financial performance by using (ROA, ROE, ROI, and PMO) based profitability financial performance measures.

According to the results, it can be concluded that corporate governance components exercise a significant effect on controlling financial performance of commercial banks. According to the participants, the highest rank significant of components were the external audit, accountability, and internal audit, respectively. Then, the audit committees, the board of directors and transparency and disclosure, that confirming there is a rank significance of the corporate governance components, these results similar to Alabede (2012) and (Davidson et al, (2005) both researchs stated the significance of external audit.

Additionally, the study found a significant relationship between corporate governance components namely; (board of directors, internal audit, external audit, transparency and disclosure, audit committees and accountability) and financial performance of commercial banks in Erbil. Transparency and disclosure and internal audit achieved the highest positive correlation, and external audit has the weakest correlation with financial performance. The findings are similar to Ball (2001) who found a positive relationship between transparency and disclosure and financial performance.

Furthermore, the regression results illustrated that statistically, the corporate governance components have all effects on financial performance. Moreover, the transparency, disclosure and audit committees achieved the strongest effects on financial performance. Additionally, the external audit has the weakest effects on financial performance in comparison with the other components.

The conclusions indicated that indeed, corporate governance components play a dynamic role in the financial performance success and fortune of the commercial banks and other commercial corporations.

5.2. Recommendations

For commercial banks operating in Erbil to have sustainable growth and stability, they should hold best practices of corporate governance which will ensure that shareholders wealth is looked after in the best way possible.

Commercial banks in Erbil should expand and invest the external audit component based on its significant role in auditing financial statements, yet, more practices of each of accountability and internal audit, audit committees, the board of directors and transparency and disclosure.

The researcher recommends that commercial banks operating in Erbil officially implement OECD principles of corporate governance within their policies and procedures.

The study recommends the commercial banks in Erbil should make their audit committee size small to improve their financial performance. Experienced directors should be assigned to committee based on their practical contextual to make them contribute more to promoting good corporate governance practice.

The study also endorses the board of directors' size of commercial banks in Erbil to be small in number to enhance financial performance, since small boards with better educational requirement are more effective in monitoring managers and improving performance.

Consequently, commercial banks should develop corporate governance policies for the selection of independent board members, establish and maintain better relations with their stakeholders, and establish the unitary model of board system, in accordance with existing legal provisions.

It is necessary to ensure that the commercial banks have necessary transparency and disclosure. Hence, in order to invest a positive relationship between transparency and disclosure and financial performance.

The study recommends the commercial banks should develop training Programs for their board administration, as well as for board of directors members, aiming at improving and advancing their corporate governance

practices in the light of the strong effect of corporate governance components on financial performance controlling.

The Iraqi central bank should come up with awards for commercial banks that practice good corporate governance to encourage banks to enhance their corporate governance and controlling their financial performance.

5.3. Practical Implications

The implication of this study consists of an allocation of the nature of the correlation between corporate governance and financial performance of commercial banks operating in Erbil-Iraq. Consequently, this information can further financial establishments understanding the corporate governance and financial performance relationship in the context of publicly commercial Iraqi corporations. Moreover, this study will contribute to corporate governance literature in emerging countries, specifically country likes Iraq and Kurdistan Region.

5.4. Suggestions for Future Study

The result of this study complements to the existing form of study literature which has also failed to find statistical significance in the relationship between corporate governance and financial performance of commercial banks. The results, however, are based only on four different financial performance variables and future study should utilize a larger number of financial factors in order to test for significance in the relationship in publicly commercial banks operating in Iraq and Kurdistan Region.

Moreover, a future study could perform similar testing's in more recent years to examine if the relationship is more significant than in the time span examined in this study. An additional suggestion for future study is to utilize a larger sample than the one collected in this study.

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APPENDIXES

Appendix (1) Questionnaire Form

Subject: Questionnaire Form

Dear Sir / Madam Respondent

This questionnaire form is a part of the study entitled **“THE ROLE OF CORPORATE GOVERNANCE IN CONTROLLING FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN ERBIL CITY**” in Partial Fulfillment of the Requirements for the Degree of Master in Management Science.

I would be pleased if you accept to participate in the research by answering the study questionnaire conferring to your experiences and knowledge as it would have a positive impact in outputting this study at the required level. Please respond as candidly as possible to the following statements by mark (√) in the appropriate place rendering to your views and thoughtful.

All information will remain confidential. Results will be aggregated by categories and reported only by statistical summaries. Information about individual hospitals will not be identified.

Thanks in advance for your time and cooperation that is deeply appreciated and respected.

Sincerely,

Supervisor
Prof. Dr. Muammer ERDOĞAN

Researcher
Twana Ali HASAN
Master Student

First: General Information

1. **Your Gender:** Male ☐ Female ☐
2. **Your Age:** Between 20 and 29 ☐ 30 and 39 ☐ 40 and 49 ☐
   Between 50 and 59 ☐ 60 and above ☐
3. **Your level of education:** Bachelor ☐ Higher Diploma ☐
   Master Degree ☐ PHD ☐
4. **Years of experience:** Less than 5 years ☐ 5-10 ☐ 11-15 ☐
   16-20 years ☐ More than 20 years ☐
5. **Scientific specialization:** Management ☐ Accounting ☐
   Finance and banking ☐ Economic ☐
   Other (please specify)……………………

Second: The Scale of Corporate Governance

This part of the scale is based on an extensive scale that includes a combination of six components: Board of Directors, Internal Audit (Internal Control Systems), External Audit, The role of Audit Committees and Accountability.

Q	Statements	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
A.	**Board of Directors** The Banks' board of directors is the elements that contribute to the implement of corporate governance through:					
1	Board of directors provides the appropriate information to stakeholders through active and effective communication channels.					
2	The commitment of the board of director's members not to their interest's conflict with the interests of the bank's financial performance.					
3	The board of directors exerts sufficient care to preserve the interests of the bank and shareholders' equity through the disclosure of information.					
4	Board of directors enjoys independence from the executive management.					
B.	**Internal Audit (Internal Control Systems)** The internal audit, internal control systems are one of the means required by the implement of corporate governance through:					
5	The bank management to provide training courses on internal auditors to inform them about the latest developments in the business.					
6	The financial and administrative control in the banks achieve by the internal audit department					
7	Establish the amount of achievement of planned targets and the effectiveness of the results by the internal audit department					
8	The internal auditor examines and assesses the presence maintained performance standards that depend on by top management.					
C.	**External Audit** The adoption of corporate governance takes the external audit an important pillar for the purpose of the implement of the fact that:					
9	To external auditing is done by a party outside the bank to examine the accounting data records.					
10	The external auditor to prepare detailed reports to attend the financial statements and eliminate asymmetric information contained.					
11	To appoint an external auditor is own due to the recruiting process.					
12	The external auditor in the bank characterized by independence, which helps to do his work efficiently and effectively.					
D.	**Disclosure and Transparency** Sufficient disclosure is one of the main instruments for implementing corporate governance through:					
13	Management has disclosed three or five-year performance					
14	Information is prepared and disclosed in accordance with International Accounting Standards.					
15	The reports are clear and informative. (Based on perception of analyst).					
16	Bank consistently discloses major and market sensitive information punctually					
E.	**The Audit Committees** The audit committees are the important mechanisms for the implementation of corporate governance the fact that audit committees:					

17	Responsible for improving public policy to disclose and report on financial performance.					
18	Plays an important role in internal control over disclosure and financial performance report process.					
19	Responsible for ensuring the quality and integrity of the financial statements of the bank.					
20	Responsible for the efficiency and effectiveness of the internal control systems of the bank.					
21	Responsible for the effective management processes to monitor and manage the risks of the financial performance of activities.					
22	The members of the audit committee are maintained by non-executives of the bank.					
F.	**Accountability** Accountability is one of the important ways to help in the implementation of corporate governance as applied means that:					
23	The executives are subject to accountability by the board of director members.					
24	The board is subject to accountability by shareholders at meetings of the general gathering.					
25	Bank management depends on accountability for negligence to correct deviations, not as punishment.					
26	The board of director actions and activities do not exclude of the accountability measures.					

Third: The Scale of Financial Performance

This part of the scale is based on a comprehensive scale that includes a combination of ten Questions (statements).

Q	Statements	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	Bank has had worthy improvement on return on equity in the last three years					
2	Bank has a better return on equity than the industry.					
3	Bank has had upright improvement on return on assets in the last three years.					
4	Bank has a better return on equity compared to the previous three years.					
5	The bank has made a positive change in return on the owner equity compared to the previous three years					
6	The rate of return on the bank's owner equity exceed the competitive banks.					
7	The bank has made a positive change in return on investment compared to the previous three years					
8	The return on investment exceeds the competitive banks.					
9	Bank has made a positive change in the profit margin of operations compared to the previous three years					
10	Banks’ Profit margin from operations exceed the competitive banks.					

Appendix (2). The Study Population and Sample

S	Commercial Bank's Name	Participated	valid responses
1	RT Bank	8	7
2	(KIB) Kurdistan International Bank	15	15
3	(IBL) International Bank of Lebanon	11	11
4	Al-Baraka Bank	5	5
5	Mosul Bank for Development & Investment	5	5
6	National Bank of Iraq	7	6
7	Cihan Bank (Bajgar Branch)	10	10
8	Bank MED	10	9
9	Trans Iraq Bank	1	1
10	Investment Bank of Iraq	2	2
11	SUMER Commercial Bank	3	3
12	(AIB) Ashur International Bank for Investment	3	3
13	IRAQI ISLAMIC BANK for investment & Development	3	3
14	TURKIYE IS BANKSI	3	2
15	Credit Bank of Lebanon	4	4
16	(ADIB) Abu Dhabi Islamic Bank	3	2
17	(CBI) Credit Bank of Iraq	2	2
18	Islamic Cooperation Bank for Investment	3	3
19	FRANSA BANK	4	3
20	Bank Audi	4	4
21	United Bank for Investment	4	4
22	Dijlah & Furat Bank for Development and Investment	5	5
23	Mansour Bank	5	5
24	Ashur Bank	5	5
Sample			119

Appendix (3): Resume/ (C.V)

ÖZGEÇMİŞ

KİŞİSEL BİLGİLER

Adı Soyadı	**Twana Ali HASAN**
Doğum Yeri	**Erbil irak**
Doğum Tarihi	**18. 5.1989**

LİSANS EĞİTİM BİLGİLERİ

Üniversite	**Salahaddin Üniversitesi**
Fakülte	**İktisadi İdari**
Bölüm	**Muhasebe**

YABANCI DİL BİLGİSİ

İngilizce	**KPDS (…..) ÜDS (….) TOEFL (….) EILTS (….)**
…	**OSA and Macos ESL**

İŞ DENEYİMİ

Çalıştığı Kurum	**Kürdistan Parlamentosu**
Görevi/Pozisyonu	**Denetçi**
Tecrübe Süresi	**4 yıl**

KATILDIĞI

Kurslar	**Arap Dili**
Projeler	**Baclores Derecesi Araştırması Göndermek**

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