

**CORPORATE GOVERNANCE, AUDITOR QUALITY
AND THE RELIABILITY OF AUDITED FINANCIAL
STATEMENTS IN LIBYAN BANKING SECTOR**

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BANKING SECTOR**

By

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**Thesis Submitted to
Othman Yeop Abdullah Graduate School of Business
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ABSTRACT

This study attempts to provide evidence on the relationship between corporate governance mechanisms, auditor quality, and reliability of audited financial information in Libya. The objectives of the study are to extend the evidence linking external corporate governance mechanisms to auditor quality, examine the relationship between internal corporate governance practices and auditor quality, investigate the relationship between auditor quality and reliability of audited financial statements, and examine the mediating effect of auditor quality on the relationship between corporate governance mechanisms and the reliability of audited financial statements in the Libyan Banking Sector. The primary data for this study is gathered by using survey technique so the data used in this study is primary in nature. Convenient sampling is used to gather the data and the main respondent of this study are auditors and loan officers of banking sector of Libya. Then correlation and regression analysis are used to acquire empirical results from the data gathered, by using spss. The main findings indicate that there is a direct significant positive relationship between corporate governance mechanisms and the reliability of audited financial statements. It is also established that there is a direct positive relationship between corporate governance practices and auditor quality. The results also reveal a direct strong positive relationship between auditor quality and the reliability of audited financial statements. In terms of mediation, the findings of the study show that auditor quality partially mediates the relationship between corporate governance mechanisms and the reliability of audited financial statements. The main contribution of the study is its in-depth investigation of financial reporting and providing an understanding of the role played by external and internal corporate governance mechanisms in the external audit process in banking sector of Libya, albeit a form of investigation rarely found in prior studies, is also used to obtain the empirical results. Furthermore, the study highlights the role of audit committee in enhancing financial reporting quality. Finally, the study also improved the understanding of why and how auditor quality influences the reliability of audited financial statements.

Keywords: corporate governance mechanisms, auditor quality, reliability of audited financial statements, Libya, banking sector

ABSTRAK

Kajian ini bertujuan untuk menyediakan bukti dalam hubungan antara mekanisme tadbir urus korporat, kualiti juruaudit, dan kebolehpercayaan maklumat kewangan yang telah diaudit di Libya. Objektif kajian ini adalah untuk melanjutkan bukti yang menghubungkan mekanisme tadbir urus korporat terhadap kualiti juruaudit luar; mengkaji hubungan antara amalan tadbir urus korporat dalaman dan kualiti juruaudit, mengkaji hubungan antara kualiti juruaudit dan kebolehpercayaan penyata kewangan yang telah diaudit, dan memeriksa kesan perantara kualiti juruaudit terhadap hubungan antara mekanisme tadbir urus korporat dan kebolehpercayaan penyata kewangan yang telah diaudit dalam Sektor Perbankan di Libya. Data utama bagi kajian ini dikumpul melalui kaedah tinjauan sampel dari responden secara rawak yang terdiri daripada para juruaudit dan pegawai pinjaman. Analisis data sekunder dari kajian sedia ada juga dijalankan. Analisis korelasi dan regresi digunakan untuk menguji hipotesis serta mentafsir keputusan. Penemuan utama menunjukkan bahawa terdapat hubungan langsung yang signifikan positif antara mekanisme tadbir urus korporat dan kebolehpercayaan penyata kewangan yang telah diaudit. Juga didapati terdapat hubungan positif yang langsung antara amalan tadbir urus korporat dan kualiti juruaudit. Keputusan juga menunjukkan hubungan positif langsung yang kuat antara kualiti juruaudit dan kebolehpercayaan penyata kewangan yang telah diaudit. Dari segi pengantaraan, hasil kajian menunjukkan bahawa kualiti juruaudit sebahagiannya menjadi pengantara dalam hubungan antara mekanisme tadbir urus korporat dan kebolehpercayaan penyata kewangan yang telah diaudit. Sumbangan utama kajian ini ialah penelitiannya yang mendalam ke atas laporan kewangan dan menyediakan pemahaman tentang peranan yang dimainkan oleh mekanisme tadbir urus korporat dalaman dan luaran dalam proses audit luaran di sesebuah negara membangun, memandangkan bentuk penyiasatan sebegini jarang ditemui dalam kajian-kajian sebelumnya. Tambahan pula, kajian itu menonjolkan peranan jawatankuasa audit dalam meningkatkan kualiti laporan kewangan. Akhir sekali, kajian ini juga meningkatkan pemahaman tentang mengapa dan bagaimana kualiti juruaudit mempengaruhi kebolehpercayaan penyata kewangan yang diaudit.

Kata kunci: mekanisme tadbir urus korporat, kualiti juruaudit, kebolehpercayaan penyata kewangan yang diaudit, Libya, sektor perbankan

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LIST OF ABBREVIATIONS

AAA	American Accounting Association
AC	Audit Committee
ACC	Audit Committee Characteristics
ACE	Audit Committee Effectiveness
AICPA	American Institute of Certified Public Accountants
APB	Auditing Practicing Board
AR	Auditor Rotation
ASCA	Arab Society of Certified Accountants
BCCI	Bank of Credit and Commerce International
BRC	Blue Ribbon Committee
BTS	Bartlett's Test of Sphericity
CBL	Central Bank of Libya
CFA	Confirmatory Factor Analysis
CG	Corporate Governance
FASB	Financial Accounting Standards Board
FCCG	Finance Committee on Corporate Governance
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAO	General Accounting Office
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IASs	International Accounting Standards
ICAEW	Institute of Chartered Accountants in England and Wales

IESBA	International Ethics Standards Board
IFAC	International Federation of Accountants
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
ISAs	International Standards on Auditing
KMO	Kaiser-Meyer-Olkin
LAAA	Libyan Auditors and Accountants Association
LBL	Libyan Banking Law
LCGC	Libyan Corporate Governance Code
LGPC	Libyan General People's Committee
LSM	Libyan Stock Market
NACD	National Association of Corporate Directors
NAS	Non-Audit Services
NASD	National Association of Securities Dealers
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-operation and Development
PCA	Principal Components Analysis
PCAOB	Public Company Accounting Oversight Board
POB	Public Oversight Board
RAFS	Reliability of Audited Financial Statement
SEC	Securities & Exchange Commission
SOX	Sarbanes-Oxley Act
SPSS	Statistical Package of Social Science
TI	Transparency International
UK	United Kingdom

CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter lays out the background to the study by outlining the contexts that shape the research. It also captures the problem statement, the research questions as well as the research objectives. The importance of the study, the scope, limitations and the organisation of the study are also highlighted in this chapter.

1.1 Background of the Study

Corporate governance is currently one of the burning issues that are dominating the agenda of the business world and scholarly research. Recent corporate scandals such as BCCI, Enron Corporation, Lehman Brothers, WorldCom, HIH Insurance Group have played a critical part in attracting the increased attention and spotlight on corporate governance issues. Furthermore, these high-profile corporate and audit failures have also generated an unprecedented interest in the accounting profession, particularly auditing. Consequently, there are many more questions emerging than answers for the known lapses in the control systems that may have facilitated these corporate failures and crises. Unsurprisingly, a series of regulatory measures (corporate governance reforms) have been developed in the corporate environment to mitigate the impact of these high-profile audit scandals and failures.

Undoubtedly, one of the major imprints of the corporate governance reform regime has been the thrust to improve or enhance the reliability of reported financial information. It is imperative to note that corporate governance reforms in relation to

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