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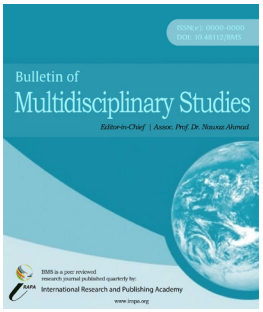

Original Article

Impact of Audit Quality on Financial Performance of Islamic and Conventional Banks: Evidence from the MENA Region

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ABSTRACT

This study examines the impact of audit quality, bank-specific factors, and political turmoil on financial performance, as measured by Return on Assets, using a fixed-effects model. The analysis is conducted on a full sample of banks and further categorised into Islamic and conventional banks. The results indicate that audit quality has a significant positive effect on Return on Assets (ROA) across all models, reinforcing the role of high-quality audits in enhancing financial performance. Bank size, leverage, liquidity, profitability before taxes, and capital adequacy ratio also exhibit strong positive relationships with ROA, emphasizing their importance in driving profitability. Political turmoil, however, presents a mixed impact, while it negatively affects the full sample, it has a significant positive effect on Islamic banks, suggesting their resilience in politically unstable environments. The fixed effects model is validated using the Hausman test, confirming its suitability for this analysis. These findings offer valuable insights for policymakers, regulators, and banking institutions in assessing financial stability and performance under varying economic conditions.

Keywords: *Audit quality, Financial performance, Fixed effects model, Islamic & conventional banks, Return on assets*

INTRODUCTION

The recent corporate failures as well as the 2007 onset global financial crisis have exposed the audit profession to political and regulatory scrutiny (Yeoh, 2010). Particularly, it has drawn considerable interest and examination from stakeholders, regulators, and investors on various financial reporting, auditing, and accounting concerns (Henderson et al., 2015). Global concern has also emerged regarding the legislative framework, audit quality, and efficacy of the corporate governance function. This is due to the fact that the global financial crisis caused the demise of some well-known corporations, and many detractors have blamed the corporate governance and auditors for their inability to prevent such a calamity. The fundamentals of business regulations had to be reevaluated by regulatory agencies in reaction to those worldwide developments (Hahn, 2000). In addition, some nations have adopted audit quality norms of best practice in an effort to stop the recent wave of savage corporate failures that have gripped the entire world and to ensure the accuracy of auditors' reports in connection to company profits (Kleinman et al., 2014).

Different studies such as Baki (2021); Ching et al., (2015); Serly and Helmayunita (2019) show that there is a significant association between financial performance and audit quality. High-quality audits can raise the financial statements' dependability and credibility, which can promote investor confidence and boost financial performance. The effectiveness of audits is a crucial variable that can impact banks' financial performance. The correctness and dependability of the financial data supplied to stakeholders must be ensured by the audit of financial statements. A strong correlation between bank financial success and audit quality. There is a connection between audit quality and financial performance, claim as indicated by banks ROA (Al-Ahdal & Hashim, 2022). They contend that thorough audits can raise the financial statements' dependability and trustworthiness, which can boost investor confidence and enhance financial performance.

Objective of the study

- To investigate the impact of audit quality on financial performance of Islamic and conventional banks in the MENA region.

Research Question

- How audit quality impacts the financial performance of Islamic and conventional banks in the MENA region?

LITERATURE REVIEW

As decision-makers, the shareholders, investors, and other stakeholders demand accurate, reliable, and pertinent financial information. This type of information is what auditors are responsible for presenting through audited financial statements. The need for quality will rise as more people realize the value that highly qualified auditors and audit firms add to financial information. Numerous studies have found that the larger audit firms deliver financial statements with high levels of quality in this regard. Previous research suggested that the size of the audit company might impact the audit's quality. Big audit firms, according to (Ojala et al., 2014) have a beneficial effect on the calibre of audit services. Big audit firms have more competent employees and better financial and technological resources to provide their services to large companies, in contrast to small audit firms, which have a very limited number of employees, clients, and financial resources and are expected to provide individualized services and meet management requirements (Zahid et al., 2022).

According to other studies, the large auditors offer high quality services since they have control roles and apply high standards, which will result in accurate financial reporting and investor reactions to these reports. According to resource-based theory, a company's capabilities and resources, including both tangible and intangible assets, can influence financial success through forging long-term competitive advantages (Lubis, 2022). Financial performance of Chinese listed companies, as determined by both ROE and ROA, is related to higher audit quality (Liu et al., 2021). The authors contend that thorough audits can raise the financial statements' dependability and trustworthiness, which can boost investor confidence and boost their financial success (Dakhli, 2022) investigated how the quality of audits impacted the financial performance of businesses and discovered a favourable correlation between audit quality and financial performance as indicated by ROA and earnings per share (EPS). According to the authors, thorough audits can boost financial statements' dependability and trustworthiness, which can boost investor confidence and boost their financial success.

Elbra et al., (2023) talked about the Big Four's emergence and function in Australia. They claimed that the Big 4 appeared as a result of an expansion of the market and the relative significance of big, sophisticated client enterprises to the economy. They came to the conclusion that the Big 4 emerged as a result of investments made by a small number of audit companies and developments in accounting and auditing that were caused by the complexity of the economy. Al Shbail et al., (2025) and Maswadeh (2024) studied the audit quality affects business success. 730 Malaysian public listed businesses' panel data was analysed. According to the study, audit quality has a beneficial impact on both ROA and Tobin's Q, two performance metrics.

Further empirical research is required to understand the implications and understand why the majority of businesses choose the Big Four Audit Firm for auditing and other services, as previous studies have shown that the topic of auditor quality is relevant to the study of auditing. Since different outcomes are predicted in this industry, it is especially important to look into how auditor quality affects firm-specific variables including ROA, ROE, leverage, and market fair value. Additionally, although not being examined in Oman, these variables are prevalent in the literature in earlier studies. The importance of the external audit in confirming the financial statements of the companies has increased since financial failures and scandals in numerous well-known companies were publicized (Ashtiani & Raahemi, 2021). Conflicts over audit quality result from differences in the dependability and calibre of the auditors and the veracity of the client's results and profits. There are no set auditing criteria because the audit's quality is unclear and multifaceted. Previous research has looked at the relationship between audit quality, earnings quality, and EM, typically using a variety of auditors' attributes as indications to the level audit quality (Sulaiman, 2023)

Despite the fact that financial reporting quality has been extensively studied, there is still limited awareness of the topic and less consensus on how to define and quantify Financial Reporting Quality (FRQ). Auditors, regulators, stakeholders, and all other parties involved in the financial reporting process may have very diverse ideas of what constitutes high-quality financial reporting, which influences the types of indicators that can be used to quantify this quality (Barać, 2021). Is there a significant difference between big external auditors' opinions and those of non-big auditors? Is a significant question that is regularly brought up in financial and accounting studies? The impartial judgement of the external auditor improves the linked parties' trust in the financial reports and boosts the effectiveness of the capital markets. Because the financial reporting must be accurate, informative, and relevant to all related parties, the quality and efficacy of the auditor's judgement is a crucial issue (Turzo et al., 2022).

Given that the customer has the freedom to choose any auditor and that there is fierce competition among audit companies, an external auditor must set himself apart from the competition. He must therefore immerse himself in a particular industry by developing a thorough understanding of and experience in that area. Auditors with knowledge and experience in a particular industry are found in audit firms, which results in the presence of efficient and reliable internal sources of client environment. They will therefore have a significant advantage over others (He et al., 2022). The extent of mistakes and misstatements in the company's financial statements should be evaluated by the external auditor. The financial performance will also be impacted by the impact of the specialised auditors in a particular industry on the audit quality. This shows that an external auditor who specialises in auditing can produce more accurate statements and offer a number of advantages (Hasibuan, 2022).

In this situation, Mnif and Ben Hamouda (2021) found no discernible variation in EM constraining between specialist and non-specialist auditors, and

the results show that the financial performance was much higher with the specialist auditors. Adeneye et al., (2024) discovered that industry specialization is successful in lowering EM practices. A considerable impact of specialized industry auditors on financial performance was also discovered by Nurbaiti and Elisabet (2023), on the other hand, found a link between industry specialization and financial statement fraud. Due to their involvement in scandals and failures at companies like Tyco International System, Enron, Global Crossing, and World Com in recent years, auditors have come under fire. Numerous issues with the audit's quality and the independence of the auditors have been brought up by the criticism. In other words, the criticism was aimed at the external auditors since they spent a lot of time auditing the customers' financial statements while focusing a lot of their attention on non-audit services.

There are a variety of opposing perspectives on the auditor tenure. According to the first school, the longer an auditor stays in one position, the more familiar the audited company becomes with the auditor, which could decrease the auditor's ability to qualify the audit report. The second viewpoint is that as an auditor's tenure increases, they become more knowledgeable about the accounting system and financial processes, which improves the audit quality (Kaawaase et al., 2021). The central question is whether businesses should frequently switch out their external auditors or maintain a close working connection with their clients. While some studies contend that a long-standing relationship between the auditor and the client enhances financial performance through expertise and learning, others contend that it lowers financial performance due to worries about independence.

Publicly traded companies in Malaysia found that audits by the Big Four had a positive effect on financial performance, as measured by higher ROA and market valuations, when contrasted with audits by firms outside of the Big Four. High audit quality positively affects banks' financial performance. By improving the credibility of financial statements, decreasing information asymmetry, and guaranteeing conformity with regulations, factors like the participation of specialized and Big 4 audit firms, increased audit fees, and efficient internal audits lead to improved financial results (Prasad et al., 2021).

Hypotheses

H_1: There is a significant relationship between Big-4 firms and financial performance.

H_2: There is a significant association among Co-Audit and financial performance.

H_3: There is a significant relationship between independent non-executive directors and financial performance.

H_4: There is a significant association among audit committee's size and financial performance.

H_5: There is a significant relationship between ACM and financial performance.

H_6: There is a significant association among ACD and financial performance.

H_7: Is there any relationship exist between growth and financial performance?

H_8: Is there any relationship exist between liabilities and financial performance?

H_9: There is exist a significant relationship between profitability and financial performance.

H_{10}: There is a significant relationship exist between liquidity and financial performance.

H_{11}: There is a significant association among CAR and financial performance.

H_{12}: There is a significant relationship between Political Turmoil and financial performance.

METHODOLOGY

Sample Selection

The data, estimated method, and data source introduced briefly in the section. In this section, we find detailed information regarding the estimation technique, as well as definitions of the variables used in our models. Our sample is based on both conventional and Islamic banks that are listed in eighteen countries, including Oman, the United Arab Emirates, Bahrain, Qatar, Kuwait, Saudi Arabia, Lebanon, Jordan, Syria, Palestine, Lebanon, Algeria, Egypt, Tunisia, Morocco, Iraq, Iran, and Yemen. Our sample includes a 13-year period beginning in 2010 and ending in 2022. It begins in 2010 since that year saw the adoption of IFRS by Islamic institutions. The countries on the list were selected based on their levels of credit, banking assets, and second-place standing in terms of the development of the banking industry. Furthermore, this area is home to the majority of Islamic banks.

We have removed the discrepancies and guarantee data accessibility. Banks without sufficient financial data and those with insufficient audit quality data (external audit, audit committee independence, audit committee size, meetings, etc.) for the whole investigation period were excluded from the sample. Data for at least four banks should be accessible for

each country included in the research to ensure the generalization of the findings. With these criteria in place, our final sample consists of 151 conventional banks and 70 Islamic banks, yielding a total of 2873 bank-year observations for our empirical analysis.

Table 1
Composition of Banks by Country

		Bank Type		Listing		Bank Ownership		Total
Country	**Total**	**Conventional**	**Islamic**	**Listed**	**Unlisted**	**Foreign**	**Govt**	**Observations**
Algeria	06	06	0	0	06	04	02	78
Bahrain	17	07	10	12	05	15	02	221
Egypt	17	12	05	11	06	12	05	221
Iran	10	06	04	07	03	09	01	130
Iraq	31	23	08	25	06	25	06	403
Jordan	12	03	09	10	02	09	03	156
Kuwait	15	08	07	11	04	12	03	195
Lebanon	12	10	02	06	06	11	01	156
Libya	08	07	01	0	08	06	02	104
Morocco	05	05	0	04	01	01	04	65
Oman	12	09	03	07	05	09	03	156
Palestine	07	04	03	02	05	06	01	91
Qatar	13	08	05	09	04	10	03	169
Saudi Arabia	17	12	05	10	07	15	02	221
Syria	09	05	04	07	02	08	01	117
Tunisia	08	08	0	06	02	06	02	104
UAE	19	14	05	18	01	10	09	247
Yemen	04	03	01	0	03	02	01	52
Total	221	151	70	145	76	170	51	2873

In this section, we provide a brief introduction of data and procedure, model and its measurement. The section discusses the estimation strategy and technique. The study has used the estimation technique for the models, Fixed and random effect models, whether the fixed or random effect model is better, we have applied the Hauseman test.

Data Source and Analysis Method

Our sample is based on both conventional and Islamic banks that are listed in 18 MENA nations. Dataset is gathered via DataStream and the annual report of banks. Our sample has a 13-year period beginning in 2010 and ending in 2022. The frequency of data used in the study includes the annual data. The study used the unbalanced data. It begins in 2010 since that year saw the adoption of IFRS by Islamic institutions (Calandra et al., 2024). Stata software is used for data analysis on the samples. In addition, methods including pooled, fixed, and random panel data analysis are employed to evaluate the hypothesis.

The random-effects method and the fixed-effects methodology both have their benefits and drawbacks when it comes to effectiveness. When deciding between the two approaches, economists refer to the Hausman evaluation (Imran et al., 2021). Using Hausman specification analysis, it is possible to differentiate between individual random effects. The Hausman test is able to identify cases of strict exogeneity. If no correlation is observed, the random effects must be employed. If correlation is found, the fixed effects must be used. That is why, in a random-effects analysis, it is crucial that there be no association between the independent variables' unobserved heterogeneity.

Dependent Variable

The literature has utilized a variety of asset risk and default risk measurements. In our study, we measured

bank financial performance using the proxy for financial performance: ROA and is also used to measure the financial performance of the both type of banks.

Bank Specific Variables (Control Variables)

The current research looks into the empirical relationship between independent variables and dependent variable. The dependent variable is the financial performance. The Independent variables are the bank specific variables and audit quality.

$$ROA_{ijt=}\ \beta_{0+}\ \beta_1 Big_{4ijt+}\beta_2 CoAudit_{ijt+}\ \beta_3 IAC_{ijt+}\ \beta_4\ ACS_{ijt}\ +\ \beta_5 ACM_{ijt}$$
$$+\ \beta_6 ACD_{ijt}\ +\ \beta_7 BankSize_{ijt+}\beta_8 Bankgrowth_{ijt+}\beta_9 Leaverage_{ijt+}$$
$$\beta_{10} Profitability_{ijt}\ +\ \beta_{11} Liqudity_{ijt}\ +\ \beta_{12} CAR_{ijt}\ +\ \beta_{13} PT_{ijt}\ +\ f_j + f_i + f_t + \mu_{ijt}$$

The above model is employed for the full sample. The same model estimated for the subsamples (Islamic banks and conventional banks) separately. Where return on asset, serves as a stand-in for financial performance, One of the Big-4 firms auditing a bank will cause a dummy variable called "Big-4" to return 1 and 0 otherwise. Co-Audit is a dummy variable that takes the value 1 if the bank is audited by two audit firms and the value 0 otherwise. IAC: the percentage of independent non-executive directors within the audit committee's full membership. ACS: based on the audit committee's size, ACM: the total number of sessions held by the audit committee during the fiscal year, ACD: depending on the logarithm of the total assets at the end of the year, the percentage of women on the audit committee.

Growth is measured as the change in all assets divided by the lag time between them. Total liabilities are split by total assets at the end of the fiscal year. Net income divided by the total lag-time assets equals profit. LIQ: defined as the ratio of Tier 1 capital, which represents actual regulatory capital, to total assets, CAR is computed at the end of the financial year by dividing current assets by current liabilities. If a bank has its headquarters in Egypt, Yemen, Syria, Tunisia, or Iraq, the dummy variable PT will have a value of 1; otherwise, it will have a value of 0.

Fixed Effects Model

When we are simply interested in analysing the effects of variables that change over time, we can utilize the fixed effect model. The fixed effect model explains the connection between predictor and result variables within an entity. Everything has unique qualities that may or may not have an impact on the predictor variable. When using fixed effects, we operate on the presumption that a factor internal to the person may have an impact and require control. This is the justification for the correlation between the error term and the predictor assumption. These time invariant qualities lose their impact when there is a fixed effect. As a result, we evaluate the predictor's overall impact on the variable outcome. Additionally, a major tenet of the fixed effects model is that each person's time-invariant features are unique from one another and should not be related to the individual characteristics. The constant and entity error term shouldn't be associated with the others. Fixed effects are inappropriate if the error terms are interrelated. This is the primary justification for using the Hauseman Test.

Random Effects Model

The rationale behind the random effects model is that it assumes that variation between entities is random rather than constant and unrelated to the independent or predictor factors included in the model. We utilized the Random Effect to see if the changes between the entities had any impact on the dependent variables. We can incorporate variables that are time invariant thanks to the random effect. The time invariant variables can act as explanatory variables since the random effect presupposes that the entity error term is not correlated with the independent variable. If there is a random effect, we must specify the specific traits of each person that could or could not have an impact on the predictor variables. Sometimes the issue is that some variables are not available, hence the model omitted the bias variables.

Fixed Effects Model or Random Effects Model (Hauseman Test)

The Houseman test was developed to evaluate whether Fixed Effects or Random Effects techniques should be used. Hauseman created a hypothesis in 1978 to determine which estimator, fixed effects or Random effects, is more effective. Hauseman created the two hypothesis testing procedures under the assumption that there are two estimators for the vector's parameter (0) and (1).

	H_0 is true	H_1 is true
b_1 (RE Estimator)	Consistent Efficient	Inconsistent
b_0 (FE Estimator)	Consistent Inefficient	Consistent Efficient

Both RE and FE are consistent if H_0 is true, however only RE is favored because of its better efficiency. If H_1 is correct, FE is favored over RE because it is at least consistent while RE is not. We have estimated the FE/RE estimator to estimate the two equations after running the Hausman test.

RESULTS & FINDINGS

Descriptive Statistics

To look at how the data is distributed, descriptive analysis is used. We provide the descriptive statistics outcomes for the pooled data, Islamic banks as well as for conventional banks set here. The tables of the descriptive statistics for full sample banks are given below.

Table 3
Descriptive Results

Variables	Obs	Mean	Std.Dev.	Min	Max	Skew.	Kurt.
ROA	2873	3.582	0.982	1.82	6.51	0.02	1.921
Audit Quality Index	2873	0	0.834	-1.493	1.004	-0.558	1.727
Bank Size	2873	18.745	2.97	10.924	27.904	0.341	2.817
Bank Growth	2873	0.122	0.146	-0.966	0.936	0.665	9.558
Leverage	2873	0.111	0.048	0.03	0.214	0.216	2.087
Liquidity	2873	3.172	1.603	0.005	7.299	0.424	2.314
Profitability	2873	4.15	2.222	1.502	14.765	2.377	9.377
CAR	2873	0.195	0.066	0.041	0.31	-0.068	1.847
PT	2873	0.339	0.474	0	1	0.679	1.46

Descriptive Statistics and Interpretation

This section presents the descriptive statistics of the key variables used in the study, including measures of central tendency (mean), dispersion (standard deviation), and distribution characteristics (minimum, maximum, skewness, and kurtosis). These statistics provide an overview of the data and highlight key patterns that may influence subsequent analyses. ROA measures the profitability of banks relative to their total assets. The mean ROA is 3.582, with a standard deviation of 0.982, indicating moderate variation in profitability across the sample.

The minimum and maximum values range from 1.82 to 6.51, suggesting that some banks achieve significantly higher profitability levels than others. The skewness value of 0.02 indicates that the distribution is approximately symmetric, while the kurtosis of 1.921 suggests a relatively normal distribution with no extreme outliers. The Audit Quality Index has a mean of 0 with a standard deviation of 0.834, suggesting moderate variability in audit quality across banks. The index ranges from -1.493 to 1.004, indicating the presence of both high and low audit quality scores. The negative skewness value (-0.558) suggests that more banks have lower audit quality scores, while the kurtosis value of 1.727 indicates a distribution with slightly fewer extreme values than a normal distribution.

Bank Size has a mean of 18.745 and a standard deviation of 2.97, suggesting substantial variation among the sample banks. The minimum and maximum values range from 10.924 to 27.904, reflecting a broad spectrum of bank sizes. The slight positive skewness (0.341) indicates that while most banks are around the mean size, a few significantly larger banks contribute to the right tail of the distribution. The kurtosis of 2.817 suggests a moderate degree of peakedness, indicating that the distribution is slightly more concentrated around the mean compared to a normal distribution. Bank Growth has a mean value of 0.122 and a standard deviation of 0.146, reflecting moderate dispersion among banks. The variable exhibits a minimum value of -0.966 and a maximum of 0.936, suggesting the presence of banks with both negative and high positive

growth rates.

The skewness of 0.665 indicates a right-skewed distribution, where a small number of banks experience exceptionally high growth. The high kurtosis value of 9.558 further supports the presence of extreme values in the distribution. Leverage has a mean of 0.111 and a standard deviation of 0.048, with values ranging between 0.03 and 0.214. The skewness (0.216) suggests a nearly symmetric distribution, while the kurtosis value of 2.087 indicates a moderate distribution shape, meaning that leverage levels among banks are fairly stable. The mean liquidity ratio is 3.172, with a standard deviation of 1.603. The values range from 0.005 to 7.299, showing that some banks maintain significantly higher liquidity than others. The positive skewness (0.424) suggests that while most banks maintain liquidity levels close to the mean, a few banks hold significantly higher liquidity. The kurtosis of 2.314 indicates a moderate level of distribution peakedness.

Profitability, measured separately from ROA, has a mean of 4.15 and a standard deviation of 2.222. The minimum and maximum values range from 1.502 to 14.765, suggesting significant variation in profitability levels across banks. The high positive skewness (2.377) indicates that most banks report moderate profitability, with a few outliers achieving significantly higher profits. The high kurtosis (9.377) confirms the presence of extreme values, suggesting that while most banks operate within a certain profitability range, a few highly profitable banks drive the overall distribution. The Capital Adequacy Ratio (CAR) has a mean of 0.195 and a standard deviation of 0.066, with values ranging from 0.041 to 0.31. The skewness value of -0.068 suggests that the distribution is nearly symmetric, while the kurtosis of 1.847 indicates a relatively normal distribution. The relatively low dispersion of CAR values suggests that most banks maintain a stable capital adequacy level in line with regulatory requirements. Political Turmoil (PT) is a binary variable (0 or 1), with a mean value of 0.339 and a standard deviation of 0.474, indicating that approximately 33.9% of the sample banks operate under political turmoil conditions. The positive skewness (0.679) suggests that the majority of observations correspond to PT = 0 (no political turmoil), while a smaller proportion of banks experience political instability. The kurtosis value of 1.46 indicates a lower peakedness, consistent with the nature of a binary variable.

Correlation Analysis

It is necessary to verify that the data is not multicollinear before doing model estimate. Multicollinearity is a problem that arises when there are substantial correlations among the independent variables. Strong associations between exogenous factors give rise to the multi-collinearity problem (Hair et al., 2010). When multicollinearity is present, model evaluations produce inaccurate and skewed findings. Standard errors and coefficients are vague. Using a Pearson correlation matrix, we checked for multicollinearity among the independent variables. There has been no specific range of correlation that suggests multicollinearity.

Table 4
Correlation Analysis

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
(1) EMP	1.000												
(2) AUDQINDX	-0.796*	1.000											
(3) NPM	-0.361*	0.543*	1.000										
(4) ROE	-0.269*	0.386*	0.614*	1.000									
(5) ROA	-0.344*	0.518*	0.744*	0.504*	1.000								
(6) Z-Score	-0.068*	0.051*	0.179*	0.283*	0.130*	1.000							
(7) Bank Size	-0.015	-0.041*	-0.064*	-0.154*	-0.065*	0.046*	1.000						
(8) Bank Growth	0.273*	-0.441*	-0.607*	-0.455*	-0.604*	-0.120*	0.236*	1.000					
(9) Leverage	0.247*	-0.372*	-0.488*	-0.377*	-0.386*	-0.025	0.066*	0.386*	1.000				
(10) Liquidity	0.268*	-0.403*	-0.506*	-0.316*	-0.509*	-0.160*	0.144*	0.453*	0.283*	1.000			
(11) Profitability	0.164*	-0.281*	-0.420*	-0.348*	-0.367*	-0.086*	0.204*	0.371*	0.216*	0.195*	1.000		
(12) CAR	0.323*	-0.449*	-0.743*	-0.557*	-0.656*	-0.229*	0.117*	0.550*	0.460*	0.481*	0.371*	1.000	
(13) PT	0.009	0.043*	-0.015	-0.059*	0.105*	-0.186*	0.006	-0.034	0.136*	-0.071*	0.039*	-0.021	1.000

The variable earnings management has a strong negative correlation with audit quality index -0.796, indicating that higher audit quality is associated with lower levels of earnings management. This suggests that banks with better audit quality tend to engage in less aggressive earnings management practices. Earnings management also exhibits a moderate negative correlation with net profit margin -0.361. This finding suggests that banks with higher earnings management tend to have lower profit margins, indicating potential manipulation of earnings. Both return on equity -0.269 and return on assets -0.344 show negative correlations with EM. This indicates that banks engaging in higher earnings management practices tend to experience lower returns, reflecting a detrimental impact on their overall profitability. The correlation with the Z-Score is relatively weak -0.068, suggesting that earnings management does not significantly impact the overall financial stability as measured by the Z-Score. This could imply that other factors may play a more substantial role in influencing financial stability.

Bank size shows a weak negative correlation with several variables, including NPM (-0.064) and ROA (-0.065), which indicates that larger banks might be experiencing lower profitability measures. Additionally, bank growth exhibits a strong negative correlation with EM (0.273), suggesting that banks with higher growth rates may be less likely to engage in earnings management. Leverage and liquidity both show positive correlations with EM (0.247 and 0.268, respectively), indicating that banks with higher leverage and liquidity may engage more in earnings management. Similarly, Profitability shows a moderate positive correlation with EM (0.164), suggesting that more profitable banks may also exhibit higher earnings management behaviour. The capital adequacy ratio displays a positive correlation with EM (0.323) and negative correlations with ROE (-0.557) and ROA (-0.656). This finding indicates that banks with higher capital adequacy might be engaging in earnings management, which could be detrimental to their profitability. The correlation of Political Turmoil with EM is weak (0.009), suggesting that political factors do not significantly influence earnings management in the sample.

Discussion

The ROA model assesses the factors influencing the profitability of banks, specifically focusing on Islamic and conventional banks as well as the overall sample. ROA is a measure of a bank's ability to generate profit relative to its total assets, representing its efficiency in utilizing resources. The independent variables include audit quality, bank size, bank growth, leverage, liquidity, profitability, capital adequacy ratio (CAR), and political turmoil. Below is the detailed interpretation of the results and their alignment with recent studies. The coefficient of full sample for audit quality is positive and significant 0.171, suggesting that better audit quality improves the ROA of banks. This indicates that enhanced transparency, governance, and financial reporting increase profitability. A similar positive relationship for the Islamic banks is 0.157, indicating that higher audit quality boosts the ROA of Islamic banks as well, though slightly lower than conventional banks. The importance of Sharia-compliant audit practices in ensuring transparency and performance in Islamic banks. The relationship is slightly stronger for conventional banks which is 0.180, implying that conventional banks benefit more from improved audit quality. This aligns with agency theory, as effective auditing reduces information asymmetry and aligns management's actions with shareholder interests, enhancing firm performance. Mnif and Ben Hamouda (2021) suggest that strong audit quality improves the performance of financial institutions, consistent with this finding.

The results are aligning with prior research by Haddad et al., (2021), which highlights that conventional banks benefit from high-quality audits, leading to better financial performance. The study conclude that the firm performance is improved and financial misreporting is decreased when audit quality is excellent because it increases financial transparency and governance. Our results are also consistent with another study which concluded that the relationship between audit quality and the effects on corporate risk and performance. The result shows that auditors' efforts improve the dependability of financial reporting, they discover that companies with higher audit quality have better financial performance and less earnings volatility (Al Shbail et al., 2025). The bank size has a positive and significant effect on ROA, with coefficients of 0.374 for the full sample, 0.440 for Islamic banks, and 0.338 for conventional banks. Larger banks can benefit from economies of scale, allowing them to reduce average costs and increase operational efficiency. They also have better access to capital and resources, enabling them to take advantage of profitable investment opportunities. The positive effect of bank size on ROA supports the economies of scale theory in banking, which suggests that larger banks have cost advantages and can leverage their size for better market positioning and risk management. Prior research,

including Ashtiani and Raahemi (2021) has shown that larger banks typically enjoy better performance due to their capacity to leverage economies of scale, thus improving profitability.

CONCLUSION

This study investigates the impact of audit quality, bank-specific factors, and political turmoil on financial performance, measured by Return on Assets (ROA), using a fixed effects model. The findings confirm that audit quality (AUDQINDX) plays a crucial role in enhancing bank profitability, with a significant positive effect across all models. Bank size, leverage, liquidity, profitability before taxes, and capital adequacy ratio are also significant determinants of financial performance, highlighting the importance of strong financial fundamentals in maintaining profitability. Notably, political turmoil (PT) exhibits contrasting effects across different banking models. While it negatively impacts the full sample, its positive effect on Islamic banks suggests that these institutions may be more resilient to political instability compared to conventional banks. This resilience could be attributed to their unique risk-sharing mechanisms and ethical banking principles. The high R-squared values indicate that the model explains a substantial portion of the variation in ROA, and the Hausman test confirms the appropriateness of the fixed effects approach. These findings provide valuable insights for regulators, policymakers, and banking institutions, emphasizing the need to strengthen audit quality, maintain adequate capital buffers, and adopt strategies that mitigate the adverse effects of political instability. Future research could explore additional macroeconomic factors and examine the long-term implications of audit quality on financial stability.

Competing Interest

The authors had no competing interests.

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