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Evaluation of the Impact of Internal Audit, Good Corporate Governance, and Intellectual capital on Financial Perfomance

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ABSTRACT

Financial performance serves as a key signal of a firm's stability and operational effectiveness. This research investigates how Internal Audit, Good Corporate Governance (GCG), and Intellectual Capital (IC) shape banks' financial outcomes, assessed through Non-Performing Loans (NPL), Return on Assets (ROA), and Return on Equity (ROE). A quantitative design was applied, utilizing secondary data extracted from the annual reports of 44 banks listed on the Indonesia Stock Exchange during 2019–2023. Multiple linear regression, processed via SPSS, was employed for analysis. Results reveal that Internal Audit and Intellectual Capital exert a significant positive effect on financial performance, whereas GCG shows no notable influence. Collectively, the three variables demonstrate a significant role in determining banking performance. The study underscores the necessity of reinforcing internal audit practices and optimizing intellectual resources to safeguard financial resilience, while also advancing theoretical discourse in banking risk management.

Keywords *: Good Corporate Governance, Internal Audit, Intellectual Capital, Non-Performing Loans, Financial Performance, Banking.*

INTRODUCTION

Financial performance is a crucial indicator reflecting the health and operational success of a company, particularly in the banking sector (Brigham & Ehrhardt, 2019). Ideally, this performance is demonstrated by financial stability, sustainable profitability, operational efficiency, and effective risk management, including maintaining the Non-Performing Loan (NPL) ratio below 5% in accordance with international standards (Kirkpatrick, 2009). Conversely, an NPL ratio above 5% indicates low levels of liquidity and solvency in banks (Quagliariello, 2007). Moreover, in the post-COVID-19 era, many Asian countries have experienced a surge in NPLs (Ghosh, 2015). Indonesia has faced similar conditions, with the banking industry recording its highest NPL ratio at 9.56% by the end of 2023, significantly exceeding the safe threshold. Nevertheless, banking performance remains relatively strong. This study evaluates it through the perspectives of Internal Audit, Good Corporate Governance, and Intellectual Capital.

To reduce NPLs, a strategic approach is needed—one that integrates governance mechanisms, intellectual capital, and effective internal controls. Good Corporate Governance (GCG) is widely recognized as a system that enhances transparency, accountability, and oversight, especially in credit management. GCG contributes to sound decision-making processes within banking operations (Kirkpatrick, 2009; Kartika et al., 2019). However, prior studies have mostly focused on the general impact of GCG without specifically analyzing its direct role in reducing NPLs.

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In addition to GCG, Intellectual Capital (IC) is considered essential for improving operational efficiency and innovation within banks. Comprised of human, structural, and relational capital, IC strengthens credit evaluation processes and risk mitigation strategies (Bontis et al., 2000; Ghosh, 2012). Nevertheless, most research on IC primarily examines its impact on overall financial performance, with limited attention given to its relationship with credit risk indicators such as NPLs, especially in the context of Indonesian banking.

Internal audit serves as a key mechanism for uncovering fraudulent activity and irregularities in credit operations. A robust internal audit system can identify control weaknesses and assist management in enhancing risk governance frameworks (Fadzil et al., 2005; Modugu & Anyaduba, 2013). Although many studies have explored the effectiveness of internal audits in improving organizational efficiency, their direct contribution to NPL management remains underexplored.

This research explores the joint influence of governance, intellectual capital, and audit functions on banking outcomes, emphasizing NPLs as the key proxy. The findings are intended to offer empirical insights into strengthening credit risk control through governance refinement and intellectual asset utilization.

1. Theoretical Basis And Hypothesis

Financial Performance

Financial performance is a critical indicator used to assess the health and success of an organization, particularly in the banking sector (Brigham & Ehrhardt, 2019). It reflects how effectively an institution manages its assets, profitability, operational efficiency, and risk management. One of the most crucial aspects of financial performance in banking is the Non-Performing Loans (NPL) ratio, which indicates the quality of a bank's credit portfolio and the effectiveness of its credit risk management (Quagliariello, 2007).

According to Ghosh (2015), a high NPL ratio can significantly threaten a bank's liquidity and solvency, ultimately weakening financial stability. In developing regions such as Asia, rising NPLs often result from economic shocks, such as post-pandemic downturns, which impair the financial resilience of banks. Therefore, NPL serves not only as a risk indicator but also as a determinant of a bank's overall financial performance (Kartika et al., 2019).

Profitability is commonly gauged through ROA, reflecting earnings relative to assets, and ROE, indicating returns on shareholder equity (Brigham & Houston, 2013). Both indicators are negatively influenced by an increase in NPL, as bad loans reduce the overall income generated by credit disbursement.

In Indonesia, the Financial Services Authority (OJK) has set regulatory thresholds for acceptable NPL ratios, generally below 5% (POJK No. 18/POJK.03/2016). Banks exceeding this benchmark are considered to have poor risk management and weak financial performance. Therefore, lowering the NPL ratio is vital for improving both internal stability and external stakeholder confidence.

Financial performance is strongly associated with the effectiveness of governance mechanisms such as Good Corporate Governance (GCG), internal audit, and intellectual capital. Effective governance ensures transparency and accountability, which strengthens

Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
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risk management and credit monitoring processes (Kirkpatrick, 2009). Meanwhile, audit internal provides early detection of financial irregularities and weaknesses in compliance (Edward Chill, 2006), and intellectual capital enhances operational efficiency and innovation (Ghosh, 2012). Together, these variables are expected to influence financial performance significantly, particularly in the context of NPL reduction and profitability enhancement.

Internal Audit

Internal audit functions as an autonomous mechanism that assures, strengthens, and optimizes organizational performance by systematically assessing internal control, risk oversight, and governance quality (The Institute of Internal Auditors, 2017). Within banking, its role becomes vital given the inherent risks in mobilizing funds and extending credit (Fadzil et al., 2005).

Although, in theory, the internal audit function plays a vital role in maintaining the quality of internal controls and minimizing credit risk (Modugu & Anyaduba, 2013), in practice, not all banks with seemingly strong internal audit systems manage to maintain low Non-Performing Loan (NPL) ratios. For instance, many Indonesian banks have well-established internal audit structures, including audit committees and regularly published internal oversight reports. However, by the end of 2023, one Indonesian bank reported an NPL ratio of 9.56%—well above the ideal threshold of 5% (OJK, 2023). This raises concerns about the actual effectiveness of internal audit implementation.

According to Monitoring Theory, internal audit functions as a monitoring mechanism that bridges the interests of management and stakeholders or shareholders (Jensen & Meckling, 1976). Internal audit helps ensure that managerial actions are aligned with organizational objectives and mitigates the risk of resource misuse. Edward Chill (2006) emphasizes that an effective internal audit can reduce fraud potential, enhance the accuracy of financial reporting, and strengthen transparency and accountability.

In banking, internal audit strengthens credit risk oversight by revealing early flaws in control mechanisms and policy adherence (Arena & Azzone, 2009). This is crucial in preventing the escalation of NPLs, which negatively impacts financial performance and investor confidence (Modugu & Anyaduba, 2013).

Indicators of internal audit efficacy are reflected in audit committee engagement, detection frequency, independence, and regulatory adherence (COSO, 2013). Enhancement in these metrics signals stronger audit capacity to address risks, while its integration into governance structures advances efficiency, credit oversight, and institutional soundness (Fadzil et al., 2005).

H1: Internal audit has a significant effect on the financial performance of banking institutions.

Good Corporate Governance

Good Corporate Governance (GCG) denotes the structural framework guiding corporate authority, encompassing norms, processes, and relationships. Its essence lies in

El-Mãl | Jurnal Kajian Ekonomi & Bisnis Islam

Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
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transparency, accountability, responsibility, independence, and fairness (OECD, 2004). In banking, GCG holds crucial weight as it underpins risk control and sustains public confidence (Kirkpatrick, 2009).

Agency Theory views corporate governance as a disciplinary tool that aligns managerial actions with shareholder interests, thereby reducing agency conflicts and safeguarding stakeholder value (Jensen & Meckling, 1976). One of the main roles of GCG is to reduce information asymmetry and monitor managerial performance effectively (Kartika et al., 2019).

Kirkpatrick (2009) argued that effective implementation of GCG principles helps banking institutions improve credit management, reduce risk exposure, and prevent the escalation of Non-Performing Loans (NPL). Transparent governance practices increase stakeholder confidence and create better oversight of credit risk evaluation and control processes.

Common indicators used to measure the quality of GCG include the proportion of independent commissioners, frequency of board meetings, existence and activity of audit committees, managerial ownership, and the level of transparency in financial and non-financial disclosures (Indonesia Corporate Governance Roadmap, 2014).

Previous studies have shown that stronger governance structures contribute to lower NPL ratios, as effective governance ensures more prudent and controlled credit distribution (Kartika et al., 2019; Claessens et al., 2002). Therefore, implementing robust corporate governance mechanisms is crucial for improving financial performance and institutional stability in banking institutions.

H2: Good Corporate Governance has a significant impact on the financial performance of banking institutions.

Intellectual Capital

Intellectual Capital denotes non-physical assets of knowledge, competence, and networks that drive value creation, with banking relying heavily on such human-based resources, information systems, and long-term customer relationships (Kumar Ghosh, 2012).

Intellectual capital encompasses human, structural, and relational dimensions. Human capital denotes workforce competence and innovative capacity in strategic and risk decisions. Structural capital reflects internal mechanisms and knowledge systems sustaining efficiency. Relational capital signifies the firm's external linkages with clients, partners, and stakeholders (Bontis et al., 2000).

According to Human Capital Theory by Becker (1964), investing in education, training, and employee development increases organizational productivity and efficiency. In banking, skilled employees enhance the accuracy of credit analysis, thereby reducing the risk of Non-Performing Loans (NPL) (Kartika et al., 2019).

Pulic's VAIC™ (2000) gauges intellectual capital by estimating how efficiently human, structural, and relational resources generate value. Previous studies by Ghosh (2012) and Agostini et al. (2017) found that organizations that manage their IC effectively

El-Mãl | Jurnal Kajian Ekonomi & Bisnis Islam

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DOI: 1047467/elmal.v6i10.10004

tend to have better financial performance and lower credit risk. This is due to their capacity to apply knowledge and innovation to risk mitigation and operational efficiency improvement.

Thus, IC serves not only as a strategic resource but also as a critical tool in minimizing credit risk and enhancing bank profitability, particularly by reducing NPL as a key financial health indicator.

H3: Intellectual Capital has a significant influence on the financial performance of banking institutions

RESEARCH METHODS

This research employs a quantitative design to assess how internal audit, governance quality, and intellectual capital affect the financial outcomes of IDX-listed banks from 2019 to 2023. The population includes banks consistently listed within the observation period, with samples selected through purposive sampling according to research relevance (Rochmatullah & Prabohudono, 2014). Data are obtained from secondary sources such as annual reports and corporate disclosures accessed via the IDX website and official bank portals. This study applies multiple regression to estimate variable linkages. Model soundness is checked through tests of normality, collinearity, variance stability, and autocorrelation. Statistical tools such as t-test, F-test, and R^2 are then used to gauge both partial and joint effects.

Operational Definition Of Variables and Measurement

This research examines financial performance as the dependent construct, represented by the Non-Performing Loan (NPL) ratio, with Internal Audit Quality, Good Corporate Governance (GCG), and Intellectual Capital as explanatory variables. Financial performance is conceptualized as a firm's capacity to sustain profitability, ensure stability, and manage credit exposure effectively.

In this context, performance is assessed using Return on Assets (ROA), Return on Equity (ROE), and NPL indicators. To obtain standardized and comparable values, each of these indicators is transformed using the Z-score formula, allowing integration into a composite index of financial performance.

Formulas:

- Z-ROA = (ROA – Mean ROA) / Standard Deviation ROA
- Z-ROE = (ROE – Mean ROE) / Standard Deviation ROE
- Z-NPL = (NPL – Mean NPL) / Standard Deviation NPL

To construct a unified measure, this study combines the three Z-scores into a composite value. Since a lower NPL indicates better performance, Z-NPL is multiplied by -1 before aggregation. Composite Financial Performance Index:

Financial Performance= Z-ROA + Z-ROE − Z-NPL

This method enables the representation of profitability and credit quality in a single performance score, allowing for more accurate analysis of financial health across companies.

El-Mãl | Jurnal Kajian Ekonomi & Bisnis Islam

Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
DOI: 1047467/elmal.v6i10.10004

(Source: Adapted from Sari & Darmayanti, 2020; Kasmir, 2015)

Internal audit represents the monitoring and evaluation function within a company, aimed at ensuring compliance, accuracy of reporting, and internal control effectiveness. In this study, Internal Audit is measured through the effectiveness of the Audit Committee, using the frequency of committee meetings as a proxy.

Effectiveness is assessed by comparing the actual number of Audit Committee meetings held with the minimum number recommended by the regulator.

Formula:

$$\text{Audit Committee Effectiveness} = \frac{\text{Number of Audit Commite Meetings}}{\text{Minimum Meetings Recommended By Regulator}} \text{ x100\%}$$

This measurement reflects how actively the Audit Committee carries out its oversight role. A higher percentage indicates greater compliance and effectiveness in internal supervision and corporate governance.

(Source: OJK Regulation No. 55/POJK.04/2015)

Good Corporate Governance (GCG) refers to the structure and processes used by corporate entities to enhance accountability, transparency, and integrity in decision-making. In this study, GCG is measured through a composite index consisting of three key indicators:

$$\text{GCG Index} = \left(\frac{\left(\frac{\text{Independent Commissioners}}{\text{Total Commissioners}} \times 100\right) + \left(\frac{\text{Commissioner Meetings}}{\text{Regulator Recommendation}} \times 100\right) + \left(\frac{\text{Audit Committee Meetings}}{\text{Regulator Recommendation}} \times 100\right)}{3} \right) \%$$

Source : Indonesia Corporate Governance Roadmap (2014)

Intellectual Capital denotes non-physical resources generating organizational value, encompassing human, structural, and relational domains. The study applies Pulic's VAIC™ framework (1998) to assess it, which includes:

- Human Capital Efficiency (HCE)
- Structural Capital Efficiency (SCE)
- Capital Employed Efficiency (CEE)

Formula:

VAIC= HCE + SCE

RESULT AND DISCUSSION

Object and Research Description

The inquiry employs statistical evaluation on IDX-listed banks releasing financial and sustainability reports during 2019–2023. From this frame, 165 firm-year data points across 44 banks form the sample, restricted to entities disclosing full annual reports with notes on governance, intellectual capital, internal audit, and performance—specifically the percentage of Non-Performing Loans (NPL)—for the 2019–2023 period. The initial dataset consisted of 220 observations, but after applying the boxplot method to detect and remove outliers, 55 data points were excluded, resulting in 165 usable observations for analysis.

El-Mãl | Jurnal Kajian Ekonomi & Bisnis Islam

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Classical Assumtion Test
Normality Test

Table 2. Normality Test

	Unstandardized Residual
Shapiro - Wilk	.076

Source: Processed secondary data, 2025

Normality of residuals was assessed through the Shapiro–Wilk test, yielding p = 0.076 (>0.05), confirming distributional adequacy. Razali and Wah (2011) note its superior sensitivity for modest samples.

Multicollinearity Test

Multicollinearity was assessed through tolerance and VIF measures, showing that Internal Audit, GCG, and Intellectual Capital each meet the threshold, with tolerance above 0.10 and VIF under 10. Specifically, Internal Audit showed a VIF of 1.707, GCG at 1.725, and Intellectual Capital at 1.020. These findings suggest that there is no multicollinearity among the independent variables, and thus the regression model is not affected by multicollinearity issues.

Table 3. Multicollinearity Test Result

Variable	Tolerance	VIF	Description
Audit_Internal	0,586	1,707	No multicollinearity
GCG	0,580	1,725	No multicollinearity
Intellectual Capital	0,980	1,020	No multicollinearity

Source: Processed secondary data, 2025

Heteroscedasticity Test

Heteroscedasticity was examined with the Glejser approach by regressing absolute residuals on the predictors. The results show that the significance values (Sig. 2-tailed) for Internal Audit, GCG and intellectual capital show significance of 1.000 (>0.05), indicating absence of heteroscedasticity and confirming homoscedasticity.

Table 4. Heteroscedasticity Test Result

sig.(2-tailed)		Description
Audit_Internal	1,000	No heteroscedasticity
GCG	1,000	No heteroscedasticity
Intellectual_Capital	1,000	No heteroscedasticity

Source: Processed secondary data, 2025

El-Mãl | Jurnal Kajian Ekonomi & Bisnis Islam

Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
DOI: 1047467/elmal.v6i10.10004

Hypothesis Testing

Multiple Linear Regression

The results of statistical data processing using SPSS produce the following output:

Table 5. Multiple Linear Regression Results

Variable	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constants)	-,153	,055		-2,799	,006
Audit_Internal	,060	,015	,360	3,926	,000
GCG	,001	,026	,003	,029	,977
Intellectual_Capital	,0,49	,014	,245	3,435	,001

Source: Processed secondary data, 2025

The intercept is −0.153, signifying a decline in the outcome when predictors are fixed. Internal audit shows a positive and significant slope (β=0.060; p<0.001), while GCG displays a negligible and non-significant effect (β=0.001; p=0.977). Intellectual capital exerts a positive and significant influence (β=0.049; p=0.001).

These findings indicate that Audit Internal and Intellectual Capital significantly influence the dependent variable, while GCG does not have a significant effect.

Simultaneous Significance Test (F-Test)

The F-statistic (14.095; p<0.001) confirms that the model is significant, indicating that internal audit, governance quality, and intellectual capital jointly affect financial performance.

Table 6. F Test Result

Model	F	Sig.
Regression	14,095	,000b
Residual		
Total		

Source: Processed secondary data, 2025

Partial Significance Test (t-Test)

Table 7. Hypothesis Test Result

Variable	Sig.	Description
Audit_Internal	,000	Accepted
GCG	,977	Rejected
Intellectual_Capital	,001	Accepted

Source: Processed secondary data, 2025

Table 6 outlines the outcomes of partial hypothesis testing derived from significance levels:

El-Mãl | Jurnal Kajian Ekonomi & Bisnis Islam

Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
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a. Internal audit is significant (p=0.000 < 0.05), supporting H1.
b. Governance shows no effect (p=0.977 > 0.05), rejecting H2.
c. Intellectual capital is significant (p=0.001 < 0.05), supporting H3.

Coefficient of Determination (R square Test)

Table 8. Result of Determination Coefficient Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,456a	,208	,193	,22739

Source: Processed secondary data, 2025

Table 7 shows an R^2 of 0.208, meaning Audit Internal, GCG, and Intellectual Capital jointly clarify 20.8% of the dependent variation, while 79.2% stems from unobserved factors. The adjusted R^2 of 0.193 confirms the model's moderate explanatory scope after correction for predictors.

Discussion

Internal Audit has a significant effect on Financial Performance

The analysis reveals that Internal Audit significantly shapes financial outcomes (p = 0.000 < 0.05), consistent with Modugu and Anyaduba (2013), which emphasizes that a strong internal audit function enhances risk control and improves financial reporting accuracy, ultimately supporting better financial outcomes. This study also supports the results of Fadzil et al. (2005), who argue that the internal audit function contributes to the early detection of non-compliance and weaknesses in credit operations, helping to reduce credit risk and lower NPL levels. A more effective audit committee, as measured in this study, reflects greater internal control and supervision in banking operations, resulting in better credit quality and profitability.

Good Corporate Governance (GCG) has no significant effect on Financial Performance

The GCG variable yields an insignificant effect on financial performance (p = 0.977 > 0.05), aligning with findings by Claessens et al. (2002), which argues that GCG does not always have a direct effect on short-term financial indicators, especially if governance practices are only implemented as formality without strong enforcement. In line with Kartika et al. (2019), the lack of significant influence may be due to uneven implementation of GCG across banks or a lack of transparency in the governance process, which causes the intended impact of governance practices not to materialize in performance improvements. This suggests that the presence of GCG structures alone is not sufficient unless supported by effective execution and cultural integration.

Intellectual Capital has a significant effect on Financial Performance

Intellectual Capital shows a significant positive impact on financial performance (p = 0.001 < 0.05), corroborating Ghosh (2012) who emphasizes its role—particularly Human and Structural Capital—in enhancing efficiency and credit assessment, which in turn

El-Mãl | Jurnal Kajian Ekonomi & Bisnis Islam

Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
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enhances profitability and reduces bad loans. Furthermore, this result aligns with the research of Agostini et al. (2017), which finds that organizations that effectively manage their intellectual assets have stronger financial performance and better risk control. In the context of banking, skilled human resources and well-structured information systems contribute directly to better loan decisions and lower NPL ratios.

Simultaneous Effect of All Variables

The F-test results show that Internal Audit, GCG, and Intellectual Capital simultaneously have a significant effect on financial performance (Sig. = 0.000). This indicates that although GCG may not show a partial effect, its presence alongside the other two variables contributes meaningfully to the overall model. The combined effect supports the theoretical assumption that internal controls, governance frameworks, and intangible assets work best when integrated into a cohesive system.

This finding is in line with the Monitoring Theory and Agency Theory, which state that multi-layered oversight mechanisms are essential to ensure effective management and long-term financial health, especially in high-risk sectors like banking.

CONCLUSION

This research empirically investigates how Internal Audit, Good Corporate Governance, and Intellectual Capital influence the financial outcomes of Indonesian banks listed on the IDX between 2019 and 2023. A quantitative design with multiple regression in SPSS is applied, where performance is proxied by a composite Z-score of ROA, ROE, and NPL. Findings reveal that Internal Audit and Intellectual Capital exert a significant positive impact on financial performance. A more effective internal audit committee enhances the bank's internal control, thereby reducing credit risk and improving profitability. Likewise, the strategic management of intellectual capital contributes to operational efficiency, better credit analysis, and stronger financial outcomes. However, the Good Corporate Governance (GCG) variable does not show a significant effect on financial performance. This suggests that the presence of formal governance structures such as independent commissioners and audit committee meetings alone may not be sufficient to directly influence financial outcomes unless supported by effective implementation and strong oversight culture.

The regression results reveal that the three predictors collectively shape financial outcomes, underscoring the role of internal control, governance mechanisms, and intellectual resources must be integrated to achieve better financial results. This study is limited to banking companies over a five-year period, with a focus on three independent variables. Future research is recommended to expand the sample across sectors, include longer timeframes, and incorporate additional variables such as digitalization, risk management practices, or external economic indicators to produce more comprehensive findings. Conceptually, this work enriches governance scholarship by evidencing how internal audit and intellectual capital support financial outcomes. Practically, the findings suggest that banking institutions should invest in strengthening their internal audit functions and managing intellectual assets to improve their credit quality and profitability.

Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
DOI: 1047467/elmal.v6i10.10004

Meanwhile, GCG practices need to be accompanied by effective enforcement to generate tangible financial benefits.

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Vol 6 No 10 (2025) 5036 - 5057 P-ISSN 2620-295 E-ISSN 2747-0490
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