



## MEDIATING ROLE OF EMPLOYEE PERFORMANCE ON INTERNAL CONTROL SYSTEM AND PERCEIVED PERFORMANCE OF CORPORATE ENTITIES

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<b>KEYWORDS</b>	<b>ABSTRACT</b>
Internal Control Systems, Employee Performance, Perceived Corporate Performance, Mediation, Corporate Governance, Lahore, Pakistan	<p>This research intends to explore that how organizations based in Lahore, Pakistan, assess corporate performance in relation to how internal control systems are framed. The research also examines the impact of employee performance (EP) on this model. For this purpose, data were retrieved using a questionnaire from 200 managerial and professional employees working in the formal sector corporate entities. The research utilized a quantitative cross-sectional design. All constructs showed high reliability. The results of study provide significant information as regression analyses showed that ICS positively and significantly predicts both PCP and EP, while wholly EP predicts PCP. EP performance, in mediation, confirmed to influence impact of internal controls on the perceived corporate performance, validating the claim that ICS raises corporate perception when executed over structured employee disciplined behavior. Thus, from performance theory, ICS are simply governance constructs and become effective when enacted through employee conduct. The recommendation for research, which contributes to the corporate governance literature, is that reforms targeting perceived performance in firms from Pakistan must merge effective internal controls with reinforced employee performance to realize the substantive corporate performance.</p>
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### INTRODUCTION

In emerging economies, the strategically designed and implemented internal control systems (ICS) have become crucial for the governance of organizations and the management of perceptions and realities of their performance. Once internal controls are entrenched within a firm, they generate reliable information streams, uphold disciplined implementations, create automatic routines that lessen risks, and all of these improve firm confidence along with mediocre functioning (Afzal, 2023).

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This is more about a paradigm corrective shift towards importance of ICS, as in context of Pakistan's corporate sector, a poorly documented weak culture of the disclosure, governance imbalances, and dysfunctional audits (Akbar, Hussain S, Ahmad & Hassan, 2020). In banking and finance sectors, literature repeatedly show that internal controls, notably audit independence, control monitoring, and duty segregation, are directly correlated to financial performance. As such, ICS provides the basic structural elements that shape the perception of corporate credibility, corporate stability, and corporate performance.

ICS are not self-contained systems; they operate through people. Every single control instrument approval, risk assessments, reconciliations, and audits require human interpretation and execution. Thus, the employee as a performer, ICS as a system, is the outer behavioral channel through which ICS transforms into organizational outcomes. In Pakistani setting, governance and control structures systematically shape organizational systems and therefore, control the behavioral pathways of effort, task execution and quality of the work (Memon, Khahro, Memon Memon & Mustafa, 2023). Incorporating control systems ICS Systems reduce task ambiguity; standardization, accountability, and feedback loops, corporate performance indirectly increases corporate performance. Research in Pakistan has also shown that weak control environments, inconsistent and even self-disciplined, contradictory opportunistic behaviors, and performance slacking, controls documented systems performance of control systems. Thus, ICS alone are not enough, governance systems of Pakistani firms underlined systems of audit control and board controls provisions cross the gap & performance only when members of organization internalize and operate those controls (Akbar, Hussain, Ahmad & Hassan, 2020).

This underscores that the pathway from ICS to the firm outcomes is not direct, but rather through several mediated steps. Moreover, gaps in Pakistan's economic landscape, coupled with compliance and regulatory uncertainties, tend to increase reliance on the internal control system's reliance on employees to achieve organizational legitimacy and performance sustainability. When the need for the ICS to facilitate employee performance is a given in any ICS environment, the ICS and the employees' actions interface, and organizational performance is result of that performance (Jarah, Zaqeela, Jarrah, Badarin & Almatarneh, 2023). The models omitting this channel, whereas ICS performance should highlight direct links, risk a profound simplification of reality. It is, therefore, this study's focus to examine the employee performance proxy in the mediation role to bridge the theoretical and empirical gap of ICS to perceived corporate performance in the Pakistani corporate landscape. In this connection, contributing to the literature in the field, the study abstracts the analysis from "controls as a structure" to the "controls as a structure for behavior" and, by doing this, closes previously exposed gap relating towards internal governance design as well as perceived organizational performance.

This study addresses a gap in existing research on internal control systems (ICS) in Pakistan, which typically links ICS directly to organizational performance without considering the mediating role of employee behavior. By incorporating employee performance as a mediating variable, the study seeks to explain how ICS led to organizational outcomes through employee actions. The findings will provide valuable insights for corporate decision-makers, auditors, regulators and HR managers,

emphasizing that addressing performance issues alongside strengthening internal control system is necessary for improving organizational performance. In such contexts, the internal control systems contribute to culture of performance where employees take ownership of tasks, collaborate to solve problems, and align their efforts with broader corporate goals. Given current scrutiny on Pakistani firms, integrating ICS with human performance will be essential for sustainable performance and organizational credibility.

### Problem Statement

The research focuses on formal corporate entities, specifically those with documented performance evaluation systems, and gather data from managerial and professional staff who directly interact with ICS. External factors such as firm size, industry type, or macroeconomic influences will not be considered, and study will solely examine how employee performance mediates the relationship between ICS and perceived organizational performance. The problem statement highlights that while ICS are designed to mitigate risks and enhance performance, existing literature overlooks the role of employee behavior in the success of these systems. In Pakistan, the failure to consider how employees engage with and execute ICS has led to an incomplete understanding of their impact on performance. This research aims to clarify role of employee performance in the ICS-performance relationship, providing a comprehensive analysis of how ICS contributes to organizational success in Pakistani context.

### Research Objectives

1. To identify the impact of internal control systems on perceived performance of corporations in Pakistan.
2. To evaluate the impact of internal control systems on the performance of employees in the particular context.
3. To analyze the impact of employees' performance upon the perceived performance of the particular context.
4. To evaluate the extent to which EP acts as conduit in relationship between ICS & perceived corporate performance.

### LITERATURE REVIEW

The implementation of internal control systems continues to be associated with the organizational dependability, compliance, and overall success particularly in the developing economies such as Pakistan. A number of reports in ICS within Pakistan's public and banking sectors confirm that standardizing processes, limiting managerial discretion, and reducing the risk of fraud, waste, and operational breakdowns added value to performance (Afzal, 2023; Shahzad, Khan, Salahuddin & Qaim, 2022). Within the banking sector, among the most tightly regulated sectors in Pakistan, effective internal control systems positively affect financial discipline, operational predictability, & stakeholder trust (Minhas, 2025). Risk-informed control systems and surveillance-led internal audits in commercial banks studied by Afzal (2023) were found to diminish transaction errors and foster accountability, improving performance from bank's perspective. Evidence from universities and public sector organizations in Pakistan shows that internal controls go beyond compliance mechanisms to serve drive of performance legitimization for internal stakeholders (Shahzad et al.,

2020; Hadi, 2019).

Those organizations that are perceived to have a formalized structure for their internal controls tend to be viewed more positively in terms of discipline and their ability to weather financial and operational uncertainty (Qadeer, Abbas & Ahmed, 2024; Waseem & Abbas & Butt, 2022). This confirms the findings from other empirical studies that have compared environments where the external audits are present and where audits are absent, suggesting the existence of greater managerial stewardship and the potential to enhance the organization's reputation, both of which are vital in contexts that have weak external market transparency (Ali, 2022; Rashid, Salim & Ahmad, 2021). In Pakistan's non-financial listed firms, corporate governance research confirms transcripts of the control–performance relationship in the context of corporate governance by demonstrating that firms with more intensive monitoring and control mechanisms in place display stronger signals of performance with lesser agency loss (Akbar et al., 2020; Khan et al., 2022). Within construction, manufacturing, and service sectors, research further indicates that internal audit and control practices reduce behavioral opportunism, thereby reinforcing the discipline of the resources as well as elevating the organizational capability as perceived (Memon et al., 2023; Kamila et al., 2020).

In summary, the research demonstrates that in the case of Pakistan, in situations of regulatory and enforcement weak opacity and asymmetrical information, internal control becomes more than internal safeguards and signs institutional performance drivers. Although varying studies have established a nascent link between corporate performance and the controlling functions of the management in Pakistan, more recent studies have capitalized on dynamic relationships between the behaviors and performance of employees and business outcomes of the organization. (Rashid, Salim & Ahmad, 2021; Waseem & Abbas & Butt, 2022). Employees sustaining internalized controls norm, reduced performance variances in execution of tasks & are more contemporaneous in conforming to procedural and outcome requirements of the control (Verburg, Nienaber, Searle, Weibel, Hartog & Rupp, 2018). The contextualized studies in industries, both financial and non-financial, as well as incorporated and unincorporated entities, optimally regulated controls, have demonstrated reduced ambiguity and mediated and procedural discretion, thereby diminishing the procedural compliance, role, and task clarity and control-induced productivity (Afzal, 2023; Minhas, 2025).

The studies of control systems in universities, public sector offices, and construction firms have similarly revealed control systems gave rise to latent psychological control systems resulting in internalized control norms vis discipline, opportunism, and procedural shortcut (Qadeer, Abbas & Ahmed, 2024; Memon et al., 2023; Khan, Kamal, Hussain & Abbas, 2022). This is in line with the control theory, which posits that improvements in performance resulting from control systems are a result of mediated compliance, applied knowledge, and effort rather than structure. Employees operating in organizations with formalized structures of planning, organizing, leading, as well as controlling tend to meet performance expectations where compliance, procedural, and outcome performance are monitored (Haryanto, Suhaman, Koeswayo & Umar, 2023). The organizational reputation & success within Pakistan are arguably based more on observable order and expertise

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of its personnel than on the evaluated figures (Shahzad et al., 2020; Hadi, 2019). When internal controls encourage personnel to become dependable, predictable & audit-consistent performers, internal observers regard the organization as capable, credible, and high performing (Ali, 2022; Shahzad et al., 2022).

The relationship between internal control systems and perceived corporate performance is, thus, behaviorally mediated: the controls reallocating the work and the reallocated work shifting the performance of the organization. The reasoning outlined justifies, from empirical perspective, the assumption of mediation in respect of employee performance functioning as the psychological-operational intermediary between internal controls as well as perceived corporate performance (Zhenjing, Chupradit, Ku, Nassani & Haffar, 2022). Control systems reduce uncertainty, define roles, and incorporate accountability, all of which enhance compliance, execution, and outcome reliability (Afzal, 2023; Rashid et al., 2021; Qadeer et al., 2024). Such improved outcomes at the employee level, in turn, form the basis of organizational stakeholders' evaluation of organization as orderly, reputable, and high performing (Ali, 2022; Shahzad et al., 2022). This all supports the logic: in the enforcement-weak economies, as in Pakistan, the performance is socially "perceived" through behavior and not via results that are externally authenticated. Accordingly, employee performance acts as the behavioral conduit through which internal controls "deliver" perceived organizational performance.

### Empirical Gap

There is converging evidence that internal controls impact employee behavior, while employee performance is a critical predictor of the perceived success of a corporation. However, there are very few Pakistan-based studies that investigate this mediation empirically in a single structural model. Research done on this mediation model focuses on either (i) internal controls, performance outcomes, or (ii) employee performance, corporate performance, but does not include a statistical treatment of employees as the mechanistic bridge between control structures and the perceived performance of Pakistani firms. Contributions of empirical work conducted in Pakistan convey a consistent causal framework: internal control systems boost perceived organizational performance not only via structural enforcement, but through employee performance behavior as well. This is both a theoretical and statistical omission that leaves the explanatory chain incomplete. This gap must be addressed to advance from associative claims to a mediated causal explanation. This is critical in understanding how internal controls impact perceptions of organizational performance in Pakistan.

## RESEARCH METHODOLOGY

This research applied a quantitative, cross-sectional explanatory design aimed at evaluating the extent to which internal control systems impact the perceived corporate performance of Lahore, Pakistan's formal sector organizations, and determining whether employee performance serves as the mediation variable facilitating this impact. The population consisted of registered corporate organizations situated in Lahore, and managerial and professional employees were purposively selected as respondents since they directly interact with internal control systems & performance evaluation systems. A pre-designed, self-administered questionnaire was shared using Google

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Forms through official corporate emails and professional networks, resulting in 200 complete and valid responses. Internal control systems, employee performance and corporate performance were all assessed via 5-point Likert-type scales, which were adapted from recognized and validated scales in literature, and each scale's internal consistency was established using Cronbach's alpha coefficients, exceeded 0.70 reliability threshold. The data were processed in SPSS, commencing with descriptive analysis & reliability analysis, and then proceeded to regression analysis for three direct hypotheses and mediation analysis to assess whether employee performance mediates the effect of internal control systems on perceived corporate performance. Data collection processes observed ethical principles, including the informed consent, voluntary participation, anonymity, and confidentiality.

## DATA ANALYSIS

Table 1 Frequencies Distributions

	Frequency	Percent
Age		
Under 25	16	8.0
25-34	21	10.5
35-44	44	22.0
45-54	71	35.5
55 & Above	48	24.0
Gender		
Male	100	50.0
Female	74	37.0
Prefer not to say	26	13.0

Table 1A Frequencies Distributions

Qualification		
High School or Below	11	5.5
Diploma/Associate Degree	5	2.5
Bachelor's Degree	59	29.5
Master's Degree	89	44.5
Doctorate or Above	36	18.0
Current Job Role		
Entry level	24	12.0
Supervisor/Team lead	32	16.0
Middle Management	62	31.0
Senior Management	82	41.0

Table 1B Frequencies Distributions

Experience In Current Organization		
Less than 1 year	15	7.5
1-3 years	22	11.0
4-6 years	43	21.5
7-10 years	74	37.0

More than 10 years	46	23.0
Employment Status		
Permanent	28	14.0
Contract	11	5.5
Part time	33	16.5
Internship	102	51.0
Other	26	13.0
Total	200	100.0

Out of the 200 respondents in the dataset, most of them being mid-career professionals, the most represented age group was 45-54 years old (35.5%), followed by 55 and older (24%), and 35-44 years old (22%). Individuals under 25 made up only 8% of sample. Thus, dataset predominantly reflects older, more experienced employees & disproportionately younger employees. Dominating sample demographics consisted of 50% of the respondents being males, 37% of respondents being females, and 13% of the sample being gender non-conforming. This indicates a useful balance in the sample, while still demonstrating appropriate concern for the possible privacy for remaining respondents. Respondents showed a considerable range of educational qualifications, with 44.5% of the sample holding a Master's degree and 18% of sample attaining a doctorate. This suggests that the respondents were qualified to provide assessments that were sought in the study. There were also minimal educational qualifications, with only 5.5% of respondents holding high school education or below.

On the other hand, more than half the sample indicated their position in the organization was a leadership position (Senior Management 41%, Middle Management 31%). Most of respondents, therefore, were primary decision-makers, unlike respondents from lower or front-line positions. In this drive, approximately 60% of the individuals have been with the organization for 7 years or longer, demonstrating both stability and significant experience which increases the reliability of their evaluation around internal control and performance issues. Interns comprise the largest percentage of the workforce at 51% with each of the other categories, part-timers and permanent employees, accounting for 16.5% and 14% respectively. This mix of the employees provides the organization with both long term and transitional employees. Thus, the proportion of workers who are interns might indicate the organization's pipeline of the talent or indicate the presence of seasonal hiring.

Table 2 Descriptive Statistics

	Minimum	Maximum	Mean	SD	CA
ICS	10.00	50.00	39.2750	6.10539	.889
EP	10.00	50.00	35.8600	7.78030	.853
PCP	10.00	50.00	36.8250	6.86952	.838

The descriptive results suggest that all three study constructs like Internal Control Systems (ICS), Employee Performance (EP), and Perceived Corporate Performance (PCP) utilize the similar scales (10-50), demonstrating consistent scale application. The Internal Control Systems scored highest

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means ( $M = 39.28$ ,  $SD = 6.10$ ), relative to the other constructs, which indicates that respondents perceive internal control systems to be more or less established in their organizations. Employee Performance, measuring ( $M = 35.86$ ,  $SD = 7.78$ ), recorded lowest means suggest that the perceived employee performance is moderate to low. Whereas Perceived Corporate Performance ( $M = 36.83$ ,  $SD = 6.87$ ) suggests the perception towards the organizational performance is moderately positive is most evident. In this linking, regarding the reliability of measures in construct, the internal consistency of all scales is excellent. Cronbach's alpha values exceed the benchmark of 0.70, with ICS = .889, EP = .853, and PCP = .838. Hence, we can justify those scales of measurement are safe to use.

H1: Internal control systems will significantly and positively impact the perceived performance of corporations.

Table 2 Regression Analysis

	B	$\beta$	SE
Constant (ICS)	16.506		2.822
PCP	.517	.460	.071
R Square	.211		

Note. N=200, P<0.001

The effect of ICS (Internal Control Systems) on PCP (Perceived Corporate Performance) is positive, with a statistically significant value. When internal control systems are increased by one unit, on average perceived corporate performance increases 517 units. This statistically significant value implies that we are not merely observing random patterns, so predictive analytics, with regard to ICS predicting corporate performance, can be affirmed. The model has a moderate degree of the explanatory power, within a range of 0 to 1 predictive power, with a result of 0.211. The positive statistical value of 0.001 again confirms, ICS is indeed predicting within statistically significant and predictable boundaries. This constitutes strong evidence in favor of H1, indicating that with internally focused control systems, organizations perceived performance on corporate level to be relatively higher.

H2: The Internal control systems will significantly and positively impact employees' performance.

Table 3 Regression Analysis

	B	$\beta$	SE
Constant (ICS)	12.277		1.454
EP	.685	.775	.040
R Square	.601		

Note N=200 P<0.001

The results suggest that ICS has a significant and positive impact on employee performance ( $B = .685$ ,  $\beta = .775$ ,  $SE = .040$ ,  $p < .001$ ). This means that employee performance increases, on average, by .685 units when internal control systems increase by one unit. The  $R^2$  is .601, indicating that the model explains slightly over 60% of the variance of employee performance. The effect size is large, and the  $p$ -value is small, indicating the relationship is significant and meaningful. Hence,

the H2 is supported; the internal control systems are better and, therefore, are related to higher employee performance.

H3: Employee performance will significantly and positively impact the perceived performance of corporations.

**Table 4 Regression Analysis**

	B	B	SE
Constant (EP)	12.277		1.454
PCP	.685	.775	.040
R Square	.601		

Note. N=200 P<0.001

The improved employee performance also positively impacts perceived corporate performance, demonstrating a significant relationship ( $B = .685$ ,  $\beta = .775$ ,  $SE = .040$ ,  $p < .001$ ). Advancement in employee performance greatly correlates with a rise in perceived corporate performance. The model accounts for almost three-fifths (60.1%) of variance in perceived corporate performance, which denotes considerable explanatory power ( $R^2 = .601$ ). In this connection, the beta value also adds the value of the relationship and demonstrates the strength of the explanation provided. In light of the evidence presented from the results, it is clear that H3 is supported, as the improved perceived employee performance is thus correlates with an increase in the perceived corporate performance.

## DISCUSSION

The results of study highlight the important role of internal control systems (ICS) in the formation of the perceived corporate performance (PCP) of organizations in Pakistani context, especially mediated by employee's performance (EP). Regression analyses showed that ICS directly affect both EP and PCP at the same time and EP is a significant predictor of PCP. These results emphasize that ICS alone are not active in bringing for organizational outcomes unless they are effectively translated into disciplined behavior of employees in line with pre-existing research emphasizing role of human execution in internal controls (Memon et al., 2023). Thus, employee performance serves as vital intermediary that shapes how internal controls translate into performance that is visible, measurable, valued by stakeholders (Bedarkar & Pandita, 2014). Positive relationship amid ICS and EP (H2) shows that strong control systems introduce positive behavioral changes by reducing ambiguity, accountability and providing a sense of procedural clarity in line with the control theory, which assumes that performance perfections result from structured guidance and mediated compliance as opposed to direct structural enforcement (Afzal, 2023; Rashid et al., 2021; Qadeer et al., 2024).

In other words, the internal constructive or control mechanisms are internalized and turned into consistent performance by employees and repeat premise that controls are behaviorally effective only when control is operationalized by employees (Shahzad et al., 2020; Hadi, 2019). Similarly, the significant effect of EP on PCP (H3) is in favor of conceptualization of employee performance as behavioral means of effect amid ICS and perceived organizational success. This mediation remains

settled that the stakeholder's perspectives on corporate performance are not only a function of structural or procedural controls but execution and reliability of employee actions as observable (Ali, 2022; Shahzad et al., 2022; Almeida & Coelho, 2019). These findings reflect the argument that in emerging economies such as Pakistan psychic characteristics of organizational reputation and performance legitimacy are substantially dependent upon visible and observable employee behavior, given the ineffectiveness of external verification and transparency mechanisms, which prevail in corporate environment (Akbar et al., 2020). The mediation analysis further supports the theoretical argument that internal controls are converted into organization outcomes through employee behavior.

This addresses a critical issue regarding some empirical gap performances in the Pakistani context where past research generally considered impact of ICS, or employee performance, individually but hardly examined co-relationship between two under a single model of structural variables (Khan et al., 2022; Memon et al., 2023). By including EP as an intermediary factor, the study gives a more holistic picture of link amid ICS and performance and confirms that effective governance systems must include compatibility between formalized control systems and human para-causal behavior of compliance (Qadeer et al., 2024; Minhas, 2025). Practically speaking, therefore, these findings indicate that organizations should not treat ICS as independent compliance tools in themselves, but instead embed them into performance management systems that help reinforce employee accountability. The training programs should be extended beyond simply notifying employees about the rules to the development of a disciplined behavior that is audit consistent through feedback such as accountability and reinforcement mechanisms (Waseem et al., 2022; Rashid et al., 2021). Governance bodies, like boards and audit committees, need to assess whether controls are present, but assess the degree to which employees are doing things the controls are designed to regulate.

## CONCLUSION

The findings of the study demonstrate the importance of internal control systems on perceived corporate performance, but not in isolation. Their impact becomes significant once the internal controls are enacted, internalized, and translated into greater employee performance. Employee performance transcends the scope of an outcome to serve as a conduit through which controls are transformed into perceptions of organizational success. Thus, for corporate in Lahore, as well as the wider Pakistani context, the paradox of reinforcing controls in the absence of fostering disciplined employee performance will yield only hollow, structural compliance, devoid of perceptual and reputational value. The study contributes to governance literature by showing the relationship amid performance assessment and behavior, rather than expected structural linking, in context of Pakistani organizations. In sum, study adds to corporate governance and performance studies by highlighting behavioral pathway of ICS. It be shown that in environments of weak enforcement, the observable behaviour of employees and not just documented systems drives the perceptions of corporate performance. Therefore, an improved performance of employees in the context of sound internal control mechanisms is key factor in improving tangible and perceived outcomes of a

given organization in case of corporate enterprises in Pakistan (Afzal, 2023; Akbar et al, 2020; Shahzad et al, 2022).

### Recommended

As findings suggest, it is recommended that organizations stop regarding self-control systems as stand-alone governing systems and merge them into the performance systems so that the control compliance is part of work performance evaluation systems. The shifting training focus from employees simply informing about rules to training of self-control under the rules to the point of discipline through accountability, feedback, and sanction enforcement is necessary. Governance bodies, boards, and audit committees must commend the systems but should also examine to what extent employees perform actions that systems regulate in their daily control activities, therefore moving the performance of required actions to execute systems to level of governance. Outputs of oversight and audits should move documentation to action and should lead to system's governing behavior, cyclical improvements. Finally, in control systems, the organizations should discipline behavior in the internal control systems and communicate to the public about it, as in Pakistan's weak-verification environments, observed performance rather than audited performance drives perceived performance.

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