INTERNAL AUDIT LITERATURE REVIEW

January 2016
FOREWORD

Having its vision as “Pioneering in the Development and Wider Acceptance of Internal Auditing”, the mission of the Institute of Internal Auditing – Turkey (IIA-Turkey) is to create an added value by becoming the source of reference and assurance for professionals, institutions and society in internal audit practices in line with the international standards. To this end, the organization of the IIA-Turkey covers various different committees, including the “Academic Relations Committee”.

The purpose of the Academic Relations Committee is to organize training programs for development of knowledge, skills and competences in the internal audit field with a view to expanding and promoting the internal audit approach. To this end, the Academic Relations Committee develops its relations with consultants, academicians, students, managers of educational institutions and business / governmental bodies and authorities, and supports them academically.

Being one of the various sub-groups of the Academic Relations Committee, the “Research Sub-working Group” has been established for the purpose of making various different researches in academic world, and is comprised of members not only from academic, but also from the business world. As its first activity, this Sub-working Group has started a literature review in order to find out to which extent the academic world investigates internal audit, which plays a key role in business life and is one of the most prominent issues in sustainability of a company. Names of journals covered by “Social Science Citation Index” (SSCI) in accounting and finance world have been determined as listed below, and journals have been scanned by using “internal audit” and “internal control” as keywords in a time interval of 2010 – 2015. The articles related to the keywords have been determined in the course of this review. You may find the abstracts of these articles in the following review. This review will be repeated every year, and new articles will be added to the list. This review aims to determine the different points of view of the academic world while dealing with the “internal audit” issue, and to which direction the researches are proceeding.

Journals Reviewed:


We would like to present our thanks to Prof. Dr. Nur İrem Nuhoğlu, Seda Erdoğan and Dr. Onuralp Armağan, valuable members of our Academic Relations Committee, who have voluntarily and altruistically made great contributions to this review.

We are glad to share this review which we believe will add value to academic development of our profession, and wish success to our colleagues and academicians in their professional academic researches and studies.

Ali Kamil UZUN
Head of Academic Relations Committee
The Institute of Internal Auditing – Turkey
March, 2016
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## I. 2010-2015 JOURNAL REVIEW

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II. ABSTRACTS

1. Does Internal Audit Function Quality Deter Management Misconduct?

Standard-setters believe high-quality internal audit functions (IAFs) serve as a key resource to audit committees for monitoring senior management. However, regulators do not enforce IAF quality or require disclosures relating to IAF quality, which is in stark contrast to regulatory requirements placed on boards, audit committees, and external auditors. Using proprietary data, I find that a composite measure of IAF quality is negatively associated with the likelihood of management misconduct even after controlling for board, audit committee, and external auditor quality. This result is robust to a variety of other specifications, including controlling for internal control quality and separate estimation during the pre- and post-SOX time periods. A difference-in-differences analysis indicates that misconduct firms have low IAF quality and competence during misconduct years and improve IAF quality and competence in the post-misconduct years. These findings suggest that regulators, audit committees, and other stakeholders should consider ways to improve IAF quality.

(The Accounting Review, Matthew S. Ege, March 2015, Vol. 90, No. 2, pp. 495-527)
2. The Effect of Using the Internal Audit Function as a Management Training Ground on the External Auditor’s Reliance Decision

This study examines how using the internal audit function (IAF) as a management training ground (MTG) affects external audit fees and the external auditors’ perceptions of the IAF. Over half of all companies that have an IAF specifically hire internal auditors with the purpose of rotating them into management positions (or cycle current employees into the IAF for a short stint before promoting them into management positions). Using archival data, we find that external auditors charge higher fees to companies that use the IAF as a MTG. Using an experiment, we provide evidence as to why fees are higher. Specifically, we find that external auditors perceive internal auditors employed in an IAF used as a MTG to be less objective but not less competent than internal auditors employed in an IAF not used as a MTG. These results have important implications for the many companies that use their IAF as a MTG.

(The Accounting Review; William F. Messier, Jr., J. Kenneth Reynolds, Chad A. Simon, David A. Wood; November 2014; Vol. 86, No. 6, pp. 2131-2154)
3. How can we explain internal auditing? The inadequacy of agency theory and a labor process alternative

This paper draws on labor process theory (LPT) to explain how capitalism creates conditions that give rise to a demand for internal auditing. Internal auditing developed from the metamorphosis of capitalism during the twentieth century, when capital gradually succeeded in institutionalizing structural control of labor processes to address the problem of control in inherently antagonistic capital-labor relationships. In this control context employees, management, and the board of directors are responsible for achieving the required rate of return on capital. With the premise that the literature has not adequately theorized the role of internal auditing in this context, this paper proposes an initial theorization of the role of internal auditing as a mechanism employed by management and the board of directors to control the labor process in the generation and realization of surplus value. Internal audit's assurance services to execute business activities according to management's conceptions, and its advisory services to enhance efficiency and effectiveness, are interpreted within the firm's overarching goal of maximizing the rate of return on capital employed. Future research agenda and methodological considerations are discussed.

(Critical Perspectives on Accounting; Dessalegn Getie Mihret; Aralık 2014; Volume 25, Issue 8, December 2014, Pages 771–782)
4. Accounting, ethics and human existence: Lightly unbearable, heavily kitsch

This paper offers a critical examination of the interrelationship between accounting, ethics, and the question of the meaning of human existence. Starting with a critique of the approach, data and method in Everett & Tremblay (2014), I broadly consider how different approaches to ethics and morality within capitalist markets play out. Drawing on the work of Milan Kundera, and briefly considering perspectives on the WorldCom fraud, I consider how the themes of lightness, weight, and kitsch are emblematic of many approaches to ethics within accounting.

(Critical Perspectives on Accounting; Gordon Boyce; May 2014; Volume 25, Issue 3, Pages 197–209)
5. Organizational legitimacy, conflict, and hypocrisy: An alternative view of the role of internal auditing

This article provides a commentary on Everett and Tremblay’s (2014) analysis of ethics and internal audit by further exploring the role of the internal audit function within Nils Brunsson’s model of organized hypocrisy (Brunsson, 1986, Brunsson, 1993 and Brunsson, 2002). Specifically, we extend Everett and Tremblay’s discussion of internal auditors as ‘moral’ actors and propose that the counter-coupling of an organization’s primary outputs—talk, decision and action—provides internal auditors with the necessary tools to carry out conflicting ethical roles within the organization.

(Critical Perspectives on Accounting; Erin Burrell Nickell, Robin W. Roberts; May 2014; Volume 25, Issue 3, Pages 217–221)
6. Ethics and internal audit: Moral will and moral skill in a heteronomous field

This paper examines ethics in the field of internal audit. A set of in-depth interviews, the autobiography of ex-Vice President of Internal Audit of World Com, Cynthia Cooper, and the documents of the Institute of Internal Auditors (IIA) are all analyzed to shed light on the ethics—deontic, teleic, and aretaic—that characterize this weakly autonomous field. The paper further employs work in the field of economic sociology and Milan Kundera's literary ideas to highlight how internal auditors actively moralize markets and embrace a moral will that is ambiguous, if not conflicted. The paper further raises questions about the IIA's present offering of ethics-related resources and its ability to effectively develop moral skill in this field. In addition, and in keeping with our phronetic research approach, the paper provides suggestions aimed at improving the Institute's ethics resources.

(Critical Perspectives on Accounting; Jeff Everett, Marie-Soleil Tremblay; May 2014; Volume 25, Issue 3, Pages 181–196)
7. Internal auditors’ roles: From watchdogs to helpers and protectors of the top manager

The purpose of this paper is to understand the governance roles of internal auditors in public sector organizations. An analysis of 42 in-depth semi-structured interviews conducted with experienced internal auditors working in public administration in Quebec indicates that internal auditors perform two key roles: a protector role, further subdivided into two roles, protective shield and keeper of secrets, and a helper role, also subdivided into two roles, support of organizational performance and guide. The analysis also shows that internal auditors have developed a nuanced conception of independence defined as ‘grey independence’ in order to perform their roles. Internal auditors consider that their primary role is to serve the top manager and the organization and that they must prioritize the top manager at the expense of audit committee members. Therefore, this paper contributes to the literature on internal auditor independence. Overall, the findings suggest that internal auditing is not the governance watchdog expected by the regulatory bodies since this is not the role performed by internal auditors.

(Critical Perspectives on Accounting; Mélanie Roussy; November 2013; Volume 24, Issues 7–8, Pages 550–571)
The uncertainties of risk management: A field study on risk management internal audit practices in a Finnish municipality

The purpose of this paper is to analyze the implementation of risk management as a tool for internal audit activities, focusing on unexpected effects or uncertainties generated during its application. Design/methodology/approach - Public and confidential documents as well as semi-structured interviews are analyzed through the lens of actor-network theory to identify the effects of risk management devices in a Finnish municipality. Findings - The authors found that risk management, rather than reducing uncertainty, itself created unexpected uncertainties that would otherwise not have emerged. These include uncertainties relating to legal aspects of risk management solutions, in particular the issue concerning which types of document are considered legally valid; uncertainties relating to the definition and operationalization of risk management; and uncertainties relating to the resources available for expanding risk management. More generally, such uncertainties relate to the professional identities and responsibilities of operational managers as defined by the framing devices. Originality/value - The paper offers three contributions to the extant literature: first, it shows how risk management itself produces uncertainties. Secondly, it shows how internal auditors can assume a central role in the risk management system. Thirdly, it develops Callon’s framing/overflowing framework with the notion that multiple frames are linked and create unexpected dynamics, and applies it to the study on the effects of risk management tools in an internal audit context. It shows how, despite recurring attempts to refine risk management, further uncertainties are continuously produced, thus providing an empirical illustration of how reframing and overflowing intertwine in a continual process.

(Accounting, Auditing & Accountability; Vinnari, Eija; Skærbæk, Peter; 2014; 27.3: 489-526)
9. Accounting change: explaining the outcomes, interpreting the process

The issue of accounting change, why and how accounting evolves through time and within specific organisational settings, has been addressed by an important body of literature. This paper aims to explain why, in processes of accounting change, organisations confronting similar environmental pressures show different outcomes of change. Design/methodology/approach - Drawing on archetype theory, the paper analyses the case of two Italian local governments. Comparative case studies were carried out, reconstructing a period of 15 years. Findings - Although confronted with similar environmental pressures, the two cases show two different patterns of accounting change, where only one case is able to finally reach radical change. Accounting change can be prompted by external stimuli, but, once the change is prompted, the outcomes of the change are explained by the dynamics of intra-organisational conditions. Originality/value - The study contributes to accounting change literature by adopting an approach (i.e. archetype theory) that overcomes some of the limitations of previous studies in explaining variations in organisational change. Through this, the authors are able to explain different outcomes and paces of accounting change and point out the intra-organisational factors also affecting them in the presence of similar environmental pressures. A specification of the theoretical framework in a particular setting is also provided.

(Accounting, Auditing & Accountability; Liguori, Mariannunziata; Steccolini, Ileana; 2012; 25.1: 27-70)
10. Audit committees: practices, practitioners and praxis of governance

The purpose of this paper is to review and critique prior research on audit committees using a practice-theory lens. Research on audit committees has followed the same trajectory as early research on boards of directors, which has been criticized for its singular theoretical perspectives and methodologies that do not capture the complexity of real-world experiences/behaviors.

The authors devise an analytical framework based on practice theory to conduct the review. The authors examine what audit committees should do (i.e. best practice) vs what audit committees actually do (i.e. actual activities in practice - praxis). Attributes of audit committee members, and the relationship dynamics relevant to their role execution (i.e. practitioners), are considered.

Research on boards has found that over-emphasis on agency theory’s monitoring role negatively impacts boards’ effectiveness. The authors invoke other theories in examining what audit committees do in practice. The authors characterize the role of audit committees as oversight not monitoring. The authors question whether, similar to auditing, audit committees are blamist tools or are genuinely orientated towards supporting improvements in organizational management systems. The authors unpack the ritualistic ceremonial behaviors and symbolic endeavours vs substantive engagement by audit committees. The analytical framework also considers the "guardianship circle" around audit committees in the form of the key practitioners and their relationships: audit committee members, auditors and managers.

Drawing on the analytical framework, the authors provide directions for further opportunities for research of audit committees.

(Accounting, Auditing & Accountability; Brennan, Niamh M, Kirwan, Collette E; 2015; 28.4: 466-493)
11. Outsourcing Internal Audit Services: An Empirical Study on Queensland Public-Sector Entities

A study of Queensland public sector entities suggests outsourcing of internal audit services to be extensive (88%), with 51% of respondent agencies adopting co-sourcing and 37% of the agencies fully outsourcing. Results suggest that internal audit outsourcing is largely adopted for non-financial reasons such as lack of technological know-how and service quality rather than financial reasons. Deficiencies of current governance arrangements concerning internal audit outsourcing include a lack of audit committee involvement in outsourcing processes, particularly in co-sourcing entities, and inadequate segregation of duties whereby the same senior management is involved in key arrangements including selection, approval, negotiation and evaluation of contractual performance.

(Australian Accounting Review; Subramaniam, Nava, Ng Chew; Carey, Peter; November 2014; 14.3: 86-95)
12. A Study of the Informal Interactions between Audit Committees and Internal Auditors in Australia

This paper finds evidence for the growing importance of informal interactions between the internal audit function and the audit committee (AC) in Australia -- a relatively unexplored topic in the literature -- using a survey of Chief Audit Executives (CAEs). It also describes the nature of these informal interactions. The most innovative elements of this paper are the findings that certain personal characteristics of CAEs, the specific knowledge and expertise of the AC chair, as well as some of the AC chair's personal characteristics are associated with the existence (and increase) of informal interactions

(Australian Accounting Review; Sarens, Gerrit; Cristopher, Joe; Zaman, Mahbub; December 2013; 23.4: 307)
13. Audit Fee Reductions from Internal Audit-Provided Assistance: The Incremental Impact of Internal Audit Characteristics

This study investigates how organizational oversight status and commitment to budgetary resources of the internal audit function (IAF) impact the external auditor’s reliance on IAF-provided financial statement audit assistance.

More specifically, this paper examines the influence of IAF organizational oversight status and budgetary resources on reported audit fees, while controlling for the number of hours of IAF-provided financial statement audit assistance. We also examine the relation between audit fees and the provision of audit assistance by outsourced internal auditors compared to the fee effects associated with in-house internal audit assistance.

This study investigates how organizational oversight status and commitment to budgetary resources of the internal audit function (IAF) impact the external auditor’s reliance on IAF-provided financial statement audit assistance. More specifically, we examine the influence of IAF organizational oversight status and budgetary resources on reported audit fees, while controlling for the number of hours of IAF-provided financial statement audit assistance. We also examine the relation between audit fees and the provision of audit assistance by outsourced internal auditors compared to the fee effects associated with in-house internal audit assistance.

(Contemporary Accounting Research; Lawrence J. Abbott, Susan Parker and Gary F. Peters; Spring 2012; Volume 29 Issue 1 (94-118))
14. Internal Audit Outsourcing and the Risk of Misleading or Fraudulent Financial Reporting: Did Sarbanes-Oxley Get It Wrong?

The Sarbanes-Oxley Act of 2002 (SOX) represents a far-reaching legislative attempt to improve the quality of financial reporting in the United States in response to the major accounting frauds of the late 1990s and early 2000s (Klein 2003). A significant change imposed by SOX was to prohibit the outsourcing of internal audit services to firms’ external auditors.¹ Competing academic arguments suggest that this ban will either improve or worsen financial reporting quality. The knowledge spillover argument suggests that by both performing the external audit and providing non audit services, auditors improve overall audit quality through a deeper understanding of the client (e.g., Simunic 1984; Plitch 2002). The economic bonding argument suggests that overall audit quality is compromised when the external auditor provides non audit services, essentially because the external auditor is unwilling to stand up to aggressive or abusive accounting practices for fear of losing a lucrative client engagement (e.g., Simunic 1984; Moore 2002; Lindberg and Beck 2004). Given the competing predictions for how outsourcing may affect audit quality, and thus financial reporting quality, we examine whether outsourcing internal audit services to the external auditor pre-SOX is associated with higher or lower accounting risk, where accounting risk is defined as the risk that clients’ financial statements contain misleading or fraudulently reported numbers.

This study is important for several reasons. Prior research examining the relation between auditor-provided non audit services and financial reporting quality generally does not discriminate among the types of non audit services provided and produces mixed results (e.g., see Beattie and Fearnley 2002; Kinney, Palmrose, and Scholz 2004; DeFond and Francis 2005; Francis 2006; and Schneider, Church, and Ely 2006 for reviews of this literature). Assessing the impact of a specific type of non audit service on audit quality is important if different non audit services have different effects. Our study also provides insights on the impact of the SOX prohibition on external auditors’ provision of internal audit services to their clients, and provides evidence concerning whether private companies may benefit from a similar practice.² Finally, this study provides insight on how increased interaction among different parties involved in corporate governance might affect financial reporting quality.

(Contemporary Accounting Research; Douglas F. Prawitt, Nathan Y. Sharp and David A. Wood; Spring 2012; Volume 29 Issue 4 (1109-1136))
15. Internal Auditing and Corruption within Government: The Case of the Canadian Sponsorship Program

This study investigates the practices of auditing in the context of systemic public sector corruption. We focus on the Canadian federal government's sponsorship program, an advertising program aimed at countering separatism in the province of Quebec. As much as $50 million of the $338 million allocated to the program went missing, most being diverted to the campaign coffers of the governing Liberal party via a network of corrupt business executives, politicians, and government bureaucrats (Kroll, Lindquist and Avey 2005; Fraser 2007). Based on a variety of documents associated with a major government inquiry into the scandal and an in-depth interview carried out with one of its central figures, the study examines the activities of government auditors and those hired to assist them. The analysis illustrates how political considerations frame, enter into, and are exercised through audit judgments, thereby making it difficult to detect and report on potentially corrupt activities.

There are two motivations for the study. The first is to understand the practices of auditing in government settings that are prone to the selling and buying of political influence. Within both the United States and Canada, governments are the largest purchasers of goods and services, with annual spending at the federal level exceeding $450 billion and $15 billion respectively (Government of the United States2009; Government of Canada 2009). Government procurement activities are subject to an array of internal controls and auditing practices that attempt to minimize misappropriation and misuse of resources. These controls include mandatory internal audits of government departments and programs and oversight by supreme audit institutions, such as the U.S. General Accounting Office and Canada's Auditor General's Office (Dye and Stapenhurst 1998; Siame 2002; Gilman and Stout 2008). At the same time, these internal controls and auditing practices must operate in a setting where the exercise of political discretion and the buying and selling of political influence are accepted features of the institutional context (Johnston 2005). Within these settings, the exercise of discretion and sale of influence coexist with apparently strong accounting-based anti-corruption structures and democratic systems of government (Johnston 2005, 40; Anechiarico and Jacobs 1995). Moreover, while the exercise of discretion and sale of influence often occur within the norms of acceptable practice (Bourdieu 2005, 130; Johnston 2005, 60), they sometimes go beyond these norms, with the transgressions themselves becoming institutionalized in a network of systemic corruption. The current study is motivated to understand how auditing works within such contexts, especially where corruption thrives despite the presence of intensive audit activities.

(Contemporary Accounting Research; Dean Neu, Jeff Everett and Abu Shiraz Rahaman; Autumn 2013; Volume 30, Issue 3, pages 1223–1250)
16. An Analytical Model for External Auditor Evaluation of the Internal Audit Function Using Belief Functions

The purpose of this paper is to advance research in internal audit (IA) evaluation by developing an IA assessment model that considers interrelationships among specific factors used by external auditors to evaluate the strength of the IA function. The model is based on three factors identified by auditing standards and by prior academic research: Competence, Work Performance, and Objectivity (SAS 65 1991; Messier and Schneider 1988; Krishnamoorthy 2002; PCAOB 2007). We develop an analytical expression of the model using the belief function framework. By using this framework we overcome limitations of prior research regarding the modelling of interrelationships among factors and regarding difficulties in application. The results of our analysis revealed that modelling the “And” relationship is essential for assessing the strength of the IA function. As far as interrelationships are concerned, the analysis showed that when the three factors have a strong or a perfect relationship, the strength of the IA function remains high even if there is positive or negative evidence about one of the factors. This result holds as long as there are high levels of beliefs about the other two factors. Further, we demonstrate how the quality of corporate governance affects the evaluation of the IA function and how a cost benefit analysis can be applied to this framework to help determine the amount of external audit work to be carried out for compliance with the Sarbanes-Oxley Act of 2002 (SOX) and the Public Company Accounting Oversight Board (PCAOB) standards. Our analysis revealed that the extent of external audit work to be carried out by the external auditor depends on the strength of the IA function and the amount of litigation and regulatory costs likely to be faced by the external auditor.

(Contemporary Accounting Research; Vikram Desai, Robin W. Roberts and Rajendra Srivastava; Summer 2010; Volume 27, Issue 2, pages 537–575)
17. Internal Control over Financial Reporting and the Safeguarding of Corporate Resources: Evidence from the Value of Cash Holdings†

This paper tests whether internal control weaknesses (ICWs) endanger cash resources that manifests in a lower value of cash. Our results indicate that investors value liquid assets in ICW firms substantially less than they do in non-ICW firms. The negative valuation effect of weak internal control mainly concentrates on ICWs related to the control environment or overall financial reporting process. While firms remediating ICWs reverse the value loss from holding cash, firms whose internal control deteriorates or remains ineffective exhibit a lower value of cash. The marginal effect of ICWs on the value of cash remains significant after controlling for existing governance mechanisms and accounting conservatism, highlighting a unique governance role of internal control in mitigating unresolved agency problems and safeguarding corporate resources.

(Contemporary Accounting Research; Xinghua Gao and Yonghong Jia; September 2015; online available only)
18. Practice Variation in Public Sector Internal Auditing: An Institutional Analysis

This article aims to analyze the rise of practice variations in public sector internal auditing (IA), giving special attention to the role of agents’ embeddedness in multiple institutional arrangements. IA's trends of development and the characteristics of the public sector context, in fact, make IA inherently subject to multiple institutional forces that interact with the system of values and beliefs of individual internal auditors. The empirical analysis, which relies on case study methodology, highlights the inherent tensions associated with the changing role of IA and shows how different types of IA developed in three case settings, shaped by the agents’ embeddedness in different institutional fields. This article provides a more comprehensive approach to the study of IA adoption and development in public sector organizations than previous literature, and it highlights the relevance of the interplay between actors’ contemporary embeddedness in professional systems and the focal social system as a relevant source of practice variation. In this respect, the case of IA can contribute to previous studies of practice variation in the field of management accounting, shedding some light on the types of tensions that emerge when persons with mixed professional identities are involved in a field.

(European Accounting Review; Marika Arena and Kim Klarskov Jeppesen; March 2015; 1018917)
19. Internal Audit Assistance and External Audit Timeliness

Professional standards guide external auditors to consider the effect of the client's internal audit work and opportunities to utilize the direct assistance of the internal audit function when planning and conducting audits. We examine the effect of internal audit assistance on external audit timeliness via the extent of external audit delay. We hypothesize and find that internal audit assistance is negatively associated with external audit delay. We also document moderating relationships between internal audit assistance and other internal audit environment characteristics, such as the extent of internal control reliance, coordination with the external auditor, and the investment in internal audit quality. Overall, our findings have implications for firms and external auditors who are evaluating the role and use of internal audit functions. Namely, our findings suggest that internal audit assistance may not only result in audit cost savings, but also in greater audit efficiencies. These findings are particularly germane given the challenges faced by external auditors in the form of greater audit requirements, shorter regulatory filing deadlines, resource constraints, and audit fee pressures.

(Auditing; Abbott, Lawrance J; Parker, Susan; Peters, Gary F.; Volume 31;4 )
A company's internal audit (IA) function can be maintained in-house, outsourced to an IA service provider, or cosourced (a combination of the in-house and outsourced IA functions). This study explores the effect of these sourcing arrangements on the external auditor's assessed quality and reliance on the IA function. We predict that external auditors consider the cosourced and outsourced IA functions to be equal in terms of assessed quality and reliance. Furthermore, we predict that the external auditors' assessments of objectivity and competence will be greater for cosourced and outsourced IA functions compared to in-house IA functions; therefore, external auditors will have greater reliance on the cosourced and outsourced IA functions. Finally, we predict that when the IA service provider also provides additional tax services to the client, external auditor reliance is significantly decreased compared to when the service provider does not provide tax services. One hundred and eight CPAs participated in this study and were randomly assigned to one of five treatment conditions: in-house, cosource, outsource, cosource with tax services, and outsource with tax services. The results support our predictions and indicate that external auditors place more reliance on cosourced and outsourced IA functions compared to in-house IA functions. Furthermore, external auditors' reliance on cosourced and outsourced IA functions decreases when tax services are also provided by the IA service provider.

(Auditing; Naman K. Desai, Gregory J. Gerard, Arindam Tripathy; Volume 30;1)
21. The Impact of Internal Audit Function Quality and Contribution on Audit Delay

The number of days required to complete financial statement audits (i.e., audit delay) increased significantly with the implementation of Section 404 of the Sarbanes-Oxley Act (SOX, U.S. House of Representatives 2002). As firms' in-house experts on internal control, Internal Audit Functions (IAFs) can substantially affect financial reporting processes and, thus, audit delay. Internal auditors can help management maintain strong internal controls and assist external auditors with financial statement audits. Accordingly, we investigate whether IAF quality and the IAF’s contribution to financial statement audits affect audit delay in a sample of 292 firm-year observations drawn from the pre-SOX 404 period.

Using survey data from the Institute of Internal Auditors (IIA), we develop a comprehensive proxy for IAF quality; we measure different aspects of IAF quality (e.g., competence, objectivity, fieldwork rigor); and we measure the nature of the IAF’s contribution to financial statement audits (independently performed work and direct assistance). Results indicate audit delay is decreasing in IAF quality, and this decrease is driven by IAF competence and fieldwork quality. Delay is four days shorter when IAFs contribute to external audits by independently performing relevant work. High-quality IAFs contribute to financial statement audits by independently performing relevant work, while low-quality IAFs provide direct assistance.

(Auditing; Desai, Pizzini, Mina; Lin, Shu; Ziegenfuss, Douglas E.; Volume 34;1)
22. Corporate Managers' Reliance on Internal Auditor Recommendations

We investigate whether corporate managers' reliance on internal auditors' recommendations in an operational setting is influenced by three recommendation attributes: (1) whether the recommendation was consistent with or inconsistent with management preferences, (2) whether the recommendation was given by an outsourced or in-house internal auditor, and (3) whether the recommendation was quantitative or qualitative in nature. We use a 2*2*2 fractional factorial design to test our predictions. We find that managers change their initial position more when presented with preference-inconsistent recommendations than when presented with preference-consistent recommendations. We do not find differences in managers' reliance on the preference-inconsistent, non-quantified recommendations of outsourced versus in-house internal auditors. However, we find that managers are more likely to rely on the preference-inconsistent recommendations of in-house internal auditors when their recommendations are quantified as opposed to non-quantified, an effect that is not observed with outsourced internal auditors.

(Auditing; Burton, F Greg; Emett, Scott A; Simon, Chad A; Wood, David A. Volume 31;2)
23. Internal Auditors' Fraud Judgments: The Benefits of Brainstorming in Groups

Recent fraud scandals have encouraged actions by standard-setters to improve both corporate governance among firms and auditors' fraud investigations. Internal auditors are now viewed as playing an important role in reducing fraudulent financial reporting. Although brainstorming is not required by internal auditors, researchers and leaders in the profession suggest that it may be helpful to internal auditors in assessing and identifying risks. In this study, we investigate whether the group interaction associated with brainstorming is necessary to reap the benefits of brainstorming for internal auditors' fraud judgments. Guided by psychology theory on cognitive load, we also examine whether this group interaction can reduce a response mode bias that auditors have exhibited when assessing risk. Consistent with prior research on external auditors, we find that internal auditors who brainstorm in groups identify fewer fraud risks (i.e., quantity) than nominal groups of individual auditors who brainstorm alone, but brainstorming groups identify more quality fraud risks than nominal groups. Further, we find that auditors who assess risk qualitatively generally provide higher fraud risk assessments than those auditors who assess risk quantitatively. However, after group brainstorming this bias is reduced.

(Auditing; Burton, F Greg; Emett, Scott A; Simon, Chad A; Wood, David A. Volume 31;2)
24. The Effects of Employer and Client Identification on Internal and External Auditors’ Evaluations of Internal Control Deficiencies

The Public Company Accounting Oversight Board's (PCAOB) Auditing Standard No. 5 (AS5) encourages external auditors to rely on internal auditors to increase the efficiency of lower-risk internal control evaluations (PCAOB 2007). We use post-SOX experimental data to compare the levels and effects of employer (client) identification on the control evaluations of internal (external) auditors. First, we find that internal auditors perceive a greater level of identification with the evaluated firm than do external auditors. We also find some evidence that, ceteris paribus, internal auditors are less lenient than external auditors when evaluating internal control deficiencies (i.e., tend to support management's preferred position to a lesser extent). Further, while we support Bamber and Iyer's (2007) results by finding that higher levels of external auditor client identification are associated with more lenient control evaluations, we demonstrate an opposite effect for internal auditors—higher levels of internal auditor employer identification are associated with less lenient control evaluations. Our results are important because we are the first to capture the relative levels of identification between internal and external auditors, as well as the first to compare directly internal and external auditor leniency, both of which are important in light of AS5. That is, we provide initial evidence that external auditors’ increased reliance on internal auditors’ work, while increasing audit efficiency, also could improve audit quality by resulting in less lenient internal control evaluations, due, at least in part, to the effects of employer and client identification.

(Auditing; Burton, F Greg; Emett, Scott A; Simon, Chad A; Wood, David A. Volume 31;2)
25. Welcome to the Day-to-Day of Internal Auditors: How Do They Cope with Conflicts?

This paper proposes a "micro-level" analysis of the way in which internal auditors express role conflicts in their day-to-day practice and how they perceive, manage, and resolve them. From this perspective, I analyze real-life experiences described by 42 interviewed internal auditors. Using a theoretical lens specifically designed for this purpose, I highlight the complexity and magnitude of the role conflicts they experience during the internal audit process, along with the strategic and dynamic coping processes they mobilize, while remaining concretely grounded in their specific context. Thus, this study makes an original contribution to the development of new knowledge on internal auditing and concludes that internal auditors tend to lack independence and audit committee members often exercise disturbingly weak power (on the internal audit function), as compared to the top managers. Accordingly, this paper points to the difficulty of applying an idealized conception of independence and purist governance principles to practice. It also questions the appropriateness of considering internal auditing as a meaningful independent assurance device in operating the corporate governance "mosaic" (Cohen, Krishnamoorthy, and Wright 2002).

(Auditing; Roussy, Mélanie. Volume 34;2)
26. Management Reporting on Internal Control and Accruals Quality: Insights from a "Comply-or-Explain" Internal Control Regime

Internal control regulation remains the subject of an ongoing global debate among academics, regulators, and practitioners in terms of costs and effectiveness. This is reflected by different internal control regulations in different countries, resulting in varying management's incentives across regulatory regimes. Prior research, however, has primarily focused on the U.S. rules-based setting to study the relationship between internal control regulation and financial reporting. The purpose of this paper is to study the relationship between internal control reporting and accruals quality in an alternative internal control regime based on the "comply-or-explain principle" in The Netherlands. We show that in this setting accruals quality is not associated with the description of the internal control system, while there is evidence of a positive association with an unaudited statement of effective internal controls. Further, we find that the noncompliance rate of providing a statement of effective internal controls is relatively high, and that companies give generic explanations for noncompliance or no explanation at all. Overall, insights from different internal control regulatory regimes may further advance our knowledge on internal control regulation effectiveness.

(Auditing; Van de Poel, Katrien; Vanstraelen, Ann. Volume 30;3 )
27. A Post-SOX Examination of Factors Associated with the Size of Internal Audit Functions

This study develops and tests a conceptual model articulating factors associated with internal audit function size in the post-SOX era. These factors include audit committee characteristics, internal audit characteristics and mission, internal audit activities performed by others (including outsourced providers and other divisions within the organization), and organization characteristics. Results from a survey of 173 public and private companies reveal that internal audit function size is positively associated with: (1) better audit committee governance, (2) greater organizational experience of the chief audit executive, (3) missions involving IT auditing, (4) the use of sophisticated audit technologies, (5) the use of a staffing model in which internal audit is used for rotational leadership development, (6) organization size, and (7) the number of foreign subsidiaries that the organization possesses. Further, internal audit function size is inversely associated with: (1) the percentage of internal audit employees that are Certified Internal Auditors, and (2) the extent of assurance and compliance activities outsourced to outsiders. These results contribute to prior literature on internal audit function size by considering a variety of factors that are associated with internal audit function size in the contemporary era.

(Accounting Horizons; Anderson, Urton L; Christ, Margaret H; Johnstone, Karla M; Rittenberg, Larry E. Volume 30;3)
In this paper, we investigate the association between the audit committee's oversight of the internal audit function (IAF) and the nature of IAF activities. The importance of internal controls and of the roles of both the audit committee and the internal audit function in monitoring control activities have grown in recent years. Despite the importance of these topics, relatively little regulatory or best practices guidance addresses the distribution of IAF activities and amount of audit committee involvement with the IAF. We hypothesize that when the balance of oversight over the IAF lies with the audit committee (vis-à-vis management), the committee will steer the IAF toward a more internal-controls-oriented focus. Our hypothesis is based on the existing practice guidance in this area and the relative incentives of management and the audit committee. To test our hypothesis, we survey 134 chief internal auditors from Fortune 1000 firms regarding the amount of internal audit resources allocated across internal audit activities in fiscal year 2005. We then construct a composite measure of audit committee oversight contingent on the relative control that the audit committee has over IAF vis-à-vis management. Our composite measure is derived from three key facets of the audit committee/internal audit relationship: reporting duties, termination rights, and budgetary control. Consistent with our hypothesis, we document a strong, positive association between our audit committee oversight variable and the amount of IAF budget allocated to internal-controls-based activities.

(Accounting Horizons; Abbott, Lawrence J; Parker, Susan; Peters, Gary F. Volume 24;1)
29. Reconciling Archival and Experimental Research: Does Internal Audit Contribution Affect the External Audit Fee?

Consistent with guidelines from external auditing standards, experimental and survey research suggests that an internal audit function (IAF) can contribute in ways that lead to decreased external audit fees; however, research using archival methodologies generally finds either no relation or a positive relation between proxies for IAF contribution and external audit fees. In this paper, we provide new evidence using a unique and previously unavailable data set to develop archival proxies of internal audit contribution. We find that archival proxies for the contribution of internal audit based on Statement of Audited Standards (SAS) No. 65 are associated with lower unexpected external audit fees. We show that proxies used in prior archival studies are limited in their ability to capture the IAF’s potential contribution to external auditing, and suggest that the lack of high-quality proxies could help explain the divergent findings of experimental and survey-based studies in relation to archival studies in this area. In addition, our results suggest that fee reductions are associated with the direct assistance of, but not with reliance on, work previously performed by the internal auditor. Overall, our results provide evidence consistent with external auditing standards and with results from prior experimental and survey studies suggesting that IAFs can indeed contribute in ways that lead to lower external audit fees.

_(Behavioral Research in Accounting; Prawitt, Douglas F; Sharp, Nathan Y; Wood, David A. Volume 23;2)_
30. Chief Audit Executives’ Assessment of Internal Auditors’ Performance Attributes by Professional Rank and Cultural Cluster

This study explores chief audit executives’ perceptions of the most important performance attributes of internal auditors by professional rank and cultural cluster. A large sample of chief audit executives (CAEs) from 19 countries located in five different cultural clusters was surveyed by the Institute of Internal Auditors Research Foundation (CBOK 2006). Analysis of data generated by that survey indicates that while leadership attributes (e.g., negotiating) are perceived to be most important for upper ranks in internal auditing, technical skills (e.g., analytical) are most important for lower ranks. Also, based on the cultural relativism literature, I hypothesize and find evidence that the importance of performance attributes differs significantly by cultural cluster. For example, while Latin-American CAEs rated leadership attributes at higher levels than other cultural clusters for internal audit staff, the East-European chief audit executives assessed the importance of technical skills at higher levels than other clusters. The results of the survey provide important initial empirical support to the list of "ideal" and "desirable" performance attributes for internal auditors recently developed by the Institute of Internal Auditors (IIA 2009).

*(Behavioral Research in Accounting; Prawitt, Douglas F; Sharp, Nathan Y; Wood, David A. Volume 24;1)*
31. Chief Audit Executives' Evaluations of Whistle-Blowing Allegations

This study examines the effects of the source of whistle-blowing allegations and potential for allegations to trigger concerns about reputation threats on chief audit executives' handling of whistle-blowing allegations. The participants for this study, chief audit executives (CAEs) and deputy CAEs, evaluated whistle-blowing reports related to financial reporting malfeasance that were received from either an anonymous or a non-anonymous source. The whistle-blowing reports alleged that the wrongdoing resulted from either the exploitation of substantial weaknesses in internal controls (suggesting higher responsibility of the CAE and internal audit) or the circumvention of internal controls (suggesting lower responsibility of the CAE or internal audit). Findings indicate that CAEs believe anonymous whistle-blowing reports to be significantly less credible than non-anonymous reports. Although CAEs assessed lower credibility ratings for the reports alleging wrongdoing by the exploitation of substantial weaknesses in internal controls, they allocated more resources to investigating these allegations.

(Behavioral Research in Accounting; Guthrie, Cynthia P; Norman, Carolyn Strand; Rose, Jacob M. Volume 24;2)
32. The Effects of Using the Internal Audit Function as a Management Training Ground or as a Consulting Services Provider in Enhancing the Recruitment of Internal Auditors

This paper examines factors that influence job applicants' willingness to apply for positions in internal auditing. We predict and find evidence that job applicants are dissuaded from applying for internal audit positions. In two separate experiments involving participants at seven universities, we discover that this phenomenon is most prevalent for applicants with business experience. Experienced applicants are 20 and 33 percent less willing to apply for a position if it is labeled as "internal audit" versus "accounting" in the two experiments, respectively. In addition, we find that the only experimental condition that increases interest in applying for an internal audit position for experienced applicants occurs when the position advertises the combination of (1) a short stint in internal auditing and then a move from internal audit into a management position, and (2) work primarily related to consulting services rather than assurance services. As a potential explanation for these findings, we find evidence that participants believe other business professionals have negative stereotypes of internal auditing - which likely dissuade potential job applicants from applying to work in internal audit. The results should prove informative to practitioners, internal audit professional organizations, and business professionals concerned with high-quality corporate governance.

(Accounting Horizons, F Greg; Starliper, Matthew W; Summers, Scott L; Wood, David A.; 29; 1)
33. The Effects of Internal Audit Report Type and Reporting Relationship on Internal Auditors’ Risk Judgments

The governance literature (e.g., Archambeault, DeZoort, and Holt 2008) highlights the lack of internal audit information available to external stakeholders and discusses the need for a publicly available internal audit report (IAR) to describe the function and/or provide assurance. We study the effects of IAR type (i.e., descriptive IAR, assurance IAR) and internal audit reporting relationship (i.e., primarily to management or primarily to the audit committee) on internal auditors’ judgments. Specifically, 108 experienced internal auditors provided fraud risk and control risk assessments in an experiment where IAR type and reporting relationship were manipulated randomly between subjects. Fraud risk assessments are higher (more conservative) when internal auditors provide assurance in an IAR or when they report primarily to the audit committee. A significant interaction indicates that internal auditors provide higher control risk assessments when they provide assurance in an IAR and report primarily to the audit committee. Providing descriptive information in an IAR to external stakeholders does not significantly affect internal auditors’ fraud risk or control risk assessments. Supplemental results indicate moderate and varied support among internal auditors for the issuance of a descriptive IAR to external stakeholders, but significantly less support for the issuance of an assurance IAR. The results, in combination with Holt and DeZoort’s (2009) evidence regarding the effect of descriptive IARs on investors’ judgments, suggest the need for discussions of the value of IARs in practice.

(Accounting Horizons, Boyle, Douglas M; DeZoort, F Todd; Hermanson, Dana R. ; 29; 3)
34. External Auditor Evaluations of Outsourced Internal Auditors

In the last decade internal auditing services has been a significant area of growth for public accounting firms. Unlike the provision of external audits, the provision of outsourced internal audit services does not prohibit accounting firms from providing the client with additional services. This study investigates some implications of an outsourced internal auditor providing non-audit services. Specifically, 89 experienced external auditors completed an experiment to investigate whether external auditors will evaluate and rely on an outsourced internal auditor’s work differently when the internal auditor also provides non-audit services. Results indicate that evaluations of the outsourced internal auditors’ objectivity were negatively affected by the provision of non-audit services. Further, the differences in objectivity perceptions are tempered by the use of different personnel to provide consulting services. Competence perceptions were not affected. Results also indicate that external auditor reliance on internal audit and suggested audit fees are affected. However, these results do not appear to be tempered by audit and non-audit staffing decisions.

(Auditing, Brandon, Duane M.; 29; 2)
Correlates of Co-Sourcing/Outsourcing of Internal Audit Activities

I use responses from 1,059 chief audit executives (CAEs) of organizations located in Australia, Canada, New Zealand, South Africa, the U.K./Ireland, and the U.S. to investigate several correlates of co-sourcing and/or outsourcing (hereafter, simply “outsourcing”) of internal audit activities. An important finding of the study is that audit committee involvement is positively and significantly associated with outsourcing of internal audit activities. Interactions of audit committee involvement with organization size and location generally indicate that medium and large international/multinational organizations with audit committee involvement outsource more than medium and large local/national organizations with no audit committee involvement.

Analysis of control variables produces significance for an inverse relationship between outsourcing and value-added activities of the internal audit function, and for positive relationships between outsourcing and missing skill set and audit staff vacancies. Other control variables, such as CAE age, college degree (graduate/undergraduate), major (accounting versus others), internal audit certification, and regular meetings with the audit committee do not show significant associations with outsourcing. Also, country of residence (U.S. versus other Anglo-culture countries) is not significant, but for-profit organizations outsource significantly more of their internal audit activities than not-for-profit/governmental organizations.

(Auditing, Abdolmohammadi, Mohammad. 32; 3)
Internationally, disclosures related to greenhouse gas (GHG) emissions and energy usage have increased dramatically due to trends toward increased sustainability reporting, growing concerns about climate change, and the introduction of new legislation and taxes. Audit committees, management, internal auditors, external auditors, and other stakeholders all have a potential role in relation to GHG disclosures. Our study addresses the role of internal auditors. We conducted 29 interviews with senior audit committee members, senior accountants, in-house internal auditors, and partners specializing in internal audit from the major accounting firms. These interviews allowed us to gain insights into the present role of internal auditors in GHG/energy reporting, the factors explaining internal audit's role, and the future role of internal audit. In addition, audit committee members describe their present involvement in GHG/energy reporting. We consider the consistency of our findings with three corporate governance theories (agency theory, institutional theory, and resource dependence theory). Although our results support the importance of effective monitoring consistent with agency theory, no one theory fully explains our results.

(Auditing, Trotman, Andrew J; Trotman, Ken T. 34; 1)
37. Internal Control Reporting and Audit Report Lags: Further Evidence

Internal control reporting continues to be of significant interest to regulators and legislators, as evidenced by the internal control-related requirements of the Dodd-Frank Act (2010) and the JOBS Act (2012) to exempt smaller firms from the requirements of Section 404. We extend prior research on the association between internal control weaknesses and audit report lag by (1) using data from 2008 and 2009, (2) comparing accelerated and non-accelerated filers, and (3) examining the impact of remediation of previously disclosed internal control problems. We find that (1) in 2008, the increase in audit report lag in the presence of material weaknesses in internal control is lower for non-accelerated filers as compared to accelerated filers, and (2) while the effect of a material internal control weakness on audit report lag is significantly lower in 2009 than in 2008 for accelerated filers, there is no such change for non-accelerated filers. We also find that for firms remediating previously disclosed internal control problems, there is a significant decline in audit report lag; yet, the remediating firms continue to have higher reporting lags than firms that had clean Section 404 opinions in both years. We also find that, at least with respect to the effect of internal control problems on audit report lag, the "small accelerated filers" (defined as those with market capitalization less than $250 million) are treated by the auditors as being (1) substantively similar to other accelerated filers, and (2) quite distinct from non-accelerated filers.

(Auditing, Munsif, Vishal; Raghunandan, K; Rama, Dasaratha V. 31; 3)
38. Monitoring Effects of the Internal Audit Function: Agency Theory versus other Explanatory Variables

This study investigates (1) whether agency variables are associated with the relative size of the internal audit function (IAF); (2) whether the IAF is complementary to other monitoring mechanisms such as independent board members and an active audit committee; and (3) the impact of the control environment on the relative size of the IAF. We use data from a sample of Belgian firms. We find evidence of a monitoring role for the IAF in corporate governance. Specifically, the relative IAF size is positively related to management share ownership. Also, we find evidence for a substitution effect between independent board members and the IAF. Finally, it turns out that a supportive control environment also has a positive impact on the relative size of the IAF. Our results can benefit companies interested in assessing the current size of their IAF and the role that it can play in corporate governance.

(*International Journal of Auditing, Sarens, Gerrit; Abdolmohammadi, Mohammad J.. 15; 1*)
39. Is Compensating Audit Committee Members with Stock Options Associated with the Likelihood of Internal Control Weaknesses?

We examine whether firms with a stock option plan for their audit committee members are more likely to have internal control weaknesses. Using a sample of 486 US firms, we find that firms with a stock option plan for their audit committee members are significantly more likely to report an internal control weakness than firms without such a stock option compensation plan. Our results support a UK government report which indicates that compensating outside directors with stock options may diminish the effectiveness of these directors. Our findings suggest that stock option compensation plans may adversely affect the functioning of a firm's audit committee.

(International Journal of Auditing, Sarens, Gerrit; Abdolmohammadi, Mohammad J. 14; 3)
40. Audit Committees and Internal Control Quality: Evidence from Nonprofit Hospitals Subject to the Single Audit Act

This study examines the impact of audit committees on the internal control quality of nonprofit organizations. Based on resource dependency theory that stresses an entity’s economic needs for internal control over administering federal funding, we select a sample of nonprofit hospitals subject to the Single Audit Act in the US, from 2001 to 2008. Our results show that hospitals that had audit committees and also employed Big 4 auditors were associated with better internal control quality. In addition, we find that Big 4 auditors were negatively associated with reported deficiencies of internal control over administering major federal programs in the early years (2001-2004), but positively associated with reported deficiencies of the same kind in the later years (2005-2008), suggesting a possible effect of the Sarbanes-Oxley Act.

(International Journal of Auditing, Pridgen, Annette; Wang, Karl J..16; 2)
This study examines the association between multiple-directorships and tenure of independent audit committee members and financial misstatements in the pre- and post-Sarbanes-Oxley (SOX) reform environment. Regulatory reforms following the accounting scandals at Enron and WorldCom substantially expanded the responsibilities and scrutiny of the audit committee and, consequently, amplify the reputational and litigation risks facing the directors serving on the committee. Our results show a significant positive association between financial misstatements and multiple-directorships in the post-SOX environment. This finding suggests that independent audit committee members serving on multiple boards may be stretched too thinly to effectively perform their monitoring responsibilities. We also find a significant positive association between the tenure of independent audit committee members and financial misstatements in the post-SOX environment, suggesting that directors with longer tenure may not exercise independent judgment. These observations support calls for limits on multiple-directorships and director tenure, and add to our understanding of how independent directors’ characteristics affect the effectiveness of the audit committee.

(Auditing, Sharma, Vineeta D; Iselin, Errol R. 31; 3)