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Internal Audit Quality: a Multi-Stakeholder Analysis

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INTERNAL AUDIT QUALITY: A MULTI-STAKEHOLDER ANALYSIS

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Keywords

corporate governance, cues, determinants, information, internal audit, judgment, quality, stakeholders

Abstract

This thesis investigates the concept of internal audit quality. The internal audit function (IAF) is a key component in an organisation's corporate governance system. Despite the importance of the IAF to organisations, little is known about IAF quality beyond the viewpoint of the external auditor or beyond the IAF's role of assuring financial reporting. The objective of this thesis is to better understand what is IAF quality by considering the experiences of other corporate governance stakeholders.

To improve our understanding of IAF quality, this thesis conducts 36 semi-structured interviews with experienced participants from very large Australian firms, including audit committee members and chairs, senior management, heads of in-house IAFs, and partners of internal audit divisions from the major accounting firms. These interviews are used to examine how IAF stakeholders judge IAF quality, determine if different IAF stakeholders judge IAF quality differently, and understand the important factors IAF stakeholders consider as determinants of a quality IAF.

This thesis finds that different IAF stakeholder groups judge IAF quality differently and the IAF stakeholder groups use a select number of information cues in their judgment process. The judgments for audit committees are based on IAF outputs; the judgments of senior management are based predominantly on outcomes and supplemented by IAF outputs; in-house internal auditors' judgments are based on processes; and internal audit partners' judgments are based on outputs and outcomes. The consistency of these findings is also considered within the rubric of corporate

governance theories. The analysis suggests that stakeholders' judgments can be explained via three corporate governance theories, namely agency theory, resource dependency theory and stewardship theory.

The interviews also reveal that IAF stakeholders consider a much broader range of factors as determinants of a quality IAF than considered in extant IAF quality research which is based on three input factors of IAF quality outlined within external audit standards (competence, objectivity and work performance). The results of this thesis show that the main determinants of IAF quality considered by the participants are input factors (soft skills, technical skills, personality traits, experience and objectivity), process factors (strong relationships, the engagement closeout, the audit approach, and auditing with a business understanding), output factors (effective communication and reporting, relevant and practical findings and recommendations), and contextual factors (firm culture and ability to attract staff). Further, many of these factors are regarded as significantly more important than the factors considered in current IAF quality research.

The insights from this thesis reveal that IAF quality is complex, multi-dimensional and is assessed differently by various IAF stakeholders. Consequently, it extends our present understanding of IAF quality.

Statement of Original Authorship

This thesis is submitted to Bond University in fulfilment of the requirements of the degree of Doctor of Philosophy. This thesis represents my own original work towards this research degree and contains no material which has been previously submitted for a degree or diploma at this University or any other institution, except where due acknowledgement is made.

Signature: _____

Date: _____

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List of Abbreviations

Abbreviation	Definition
AC	Audit Committee
AICPA	American Institute of Certified Public Accountants
ASX	Australian Securities Exchange
CAE	Chief Audit Executive
CBOK	Central Body of Knowledge
CEO	Chief Executive Officer
CFO	Chief Financial Officer
FRC	Financial Reporting Council
IAASB	International Auditing and Assurance Standards Board
IAF	Internal Audit Function
IA Head	Head of an in-house IAF
IA Partner	Partner of an internal audit division within an accounting firm
IFAC	International Federation of Accountants
IIA	Institute of Internal Auditors
JDM	Judgment and Decision Making
MTG	Management Training Ground
PCAOB	Public Company Accounting Oversight Board
SM	Senior Management
SOX	Sarbanes-Oxley Act of 2002

Chapter 1: Introduction

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1.1 OVERVIEW

Heightened pressure and accountability on corporate governance actors, due to greater emphasis on sound corporate governance (Pomeroy, 2010), has increased the prominence and reliance on the internal audit function (IAF) (Cohen et al., 2010; Desai et al., 2010; Glover et al., 2008). The IAF is a key component of a firm’s corporate governance system (Anderson et al., 2012b; Archambeault et al., 2008; Brown et al., 2011; Carpenter et al., 2011; Glover et al., 2008; Krishnamoorthy and Maletta, 2008; Prawitt et al., 2011; Prawitt et al., 2009) and a resource to a number of governance stakeholders, such as the audit committee, senior management and external auditors (Gramling et al., 2004). The IAF provides these stakeholders with information on a range of important issues. As the judgments and decisions of these stakeholders are often critical to their organisations, the quality of information they receive from the IAF is of great importance and it is likely these stakeholders consider the quality of the IAF before relying on IAF information. The quality of information is a fundamental determinant in the use of that information and the resulting quality of judgments, decisions and actions of a person relying on the information (Groysberg and Lee, 2008; Neely and Cook, 2011; O’Reilly, 1982; Stvilia et al., 2007; Thayer, 2011).

The importance of a quality IAF and the importance of the quality of IAF information has long been recognised (see Anderson, 1983). Recent research has highlighted the importance of IAF quality, finding greater quality to be associated with reduced earnings management (Prawitt et al., 2009), lower accounting risk (misleading or fraudulent financial reporting) (Prawitt et al., 2012), and increased detection and prevention of material weaknesses (Lin et al., 2011). Greater IAF quality also increases external auditor reliance on the work of the IAF which improves external audit efficiency (Pizzini et al., 2012) and reduces external audit fees (Abbott et al., 2012; Felix et al., 2001). This body of research establishes that variations exist among the quality of IAFs and the importance of IAF quality to external financial reporting and external audit.

Despite this documented importance, our understanding of IAF quality is limited. To date, research on IAF quality has almost entirely focused on the relationship between IAF quality and the external audit(or). Outside of this relationship, little is known; other stakeholder perspectives and judgments of IAF quality, or how IAF quality influences stakeholders' reliance on information provided from the IAF, has not been investigated (see Lampe and Sutton (1994) for an exception).¹ Relatedly, IAF quality measures have focused on three components of quality prescribed in external audit standards: competence, objectivity and work performed (AICPA 1990; PCAOB 2007; IFAC 2009c). These factors are attributes of the internal auditor and the focus of the IAF related to financial reporting activities.

This thesis examines the concept of IAF quality from a multi-stakeholder perspective, beyond that solely of the external auditor thereby increasing our

¹ Lampe and Sutton (1994) investigate internal auditors' views of IAF quality factors compared to external auditors' views.

understanding of IAF quality. This thesis incorporates field interviews with key governance stakeholders, namely audit committee members and chairs, senior management, heads of in-house IAFs, and partners of internal audit divisions from large accounting firms, to understand how these stakeholders make judgments of IAF quality, key determinants of IAF quality, and whether there are differences among IAF quality views between different stakeholders.

1.2 MOTIVATION

Information is a critical resource in contemporary organisations and the quality of information is fundamental to decision making (Stvilia et al., 2007). However, individuals relying on information provided by others are vulnerable to the quality of that information (Levin et al., 2006). In fact, the quality of information received is a principle challenge facing audit committees (ICAA et al. 2012). The quality of information cannot be managed without being able to measure it meaningfully (Stvilia et al., 2007) and managing the quality of internal audit is critical to corporate governance (Coram et al., 2008).

Increased reliance on the IAF by multiple governance stakeholders increases the need for it to be better understood (Desai et al., 2010) as internal audit is only a valuable resource if it is viewed as possessing an appropriate level of quality (Gramling et al., 2004). Research has identified that when stakeholders perceive IAF quality to be low, stakeholders will not rely on the information or work performed by the IAF (e.g. Burton et al., 2012; Desai et al., 2010). Therefore, it is important to gain a better understanding of how different stakeholders judge IAF quality and determinants of high IAF quality.

Our current understanding of IAF quality is limited to the perspective of a single governance stakeholder – the external auditor. In a review of internal audit quality literature, Gramling et al. (2004) highlight that research has almost exclusively

examined IAF quality from the viewpoint of the external auditor. Recent IAF quality research has continued with this same focus and has not been extended to other stakeholders. There are two main reasons for this almost solitary focus on the IAF quality/external audit relationship. Firstly, until recently the IAF was generally considered a mechanism for assuring financial controls (see Ramamoorti 2003 and Moeller 2009 for reviews). Secondly, unlike other internal audit stakeholders, external auditors are mandatorily required to assess the quality of the IAF if they wish to rely on the IAF's work.

To date, measures of IAF quality have been based on three factors prescribed by external audit standards for an external auditor to consider when they wish to rely on the work of the IAF (AICPA 1990; PCAOB 2007; IFAC 2009c). The three factors are internal auditor competence, objectivity and work performance (nature and scope of activities).² Research indicates that differences in these three factors affect IAF quality. In their review, Gramling et al. (2004) encourage researchers to enhance and potentially expand measures to assess IAF quality and identify IAF quality determinants. Desai et al. (2010) develop an analytical model of external auditor evaluation of IAF quality, building on Krishnamoorthy's (2001) model, to determine an optimal level of reliance; Prawitt et al. (2009) and Lin et al. (2011) develop composite measures of IAF quality. While enhancing IAF quality measures, these studies have still been based on the external audit perspective of IAF quality. Research has also identified that external auditor assessments of IAF quality are influenced by factors such as audit committee quality (Cohen et al., 2007a; Krishnamoorthy and Maletta, 2008) and inherent risk (Glover et al., 2008), beyond the three external audit factors used in traditional IAF quality measures.

² International external audit standards also include the factor of internal auditor due care (IFAC 2009c)

Other disciplines (e.g. marketing) show that measuring quality is complex, multi-dimensional and contingent on the needs of the client(s). Quality measures developed in these disciplines include a number of determinants beyond input factors, whereas the ‘three factors’ proposed in external audit standards are solely input factors. These multiple dimensions and determinant factors are included in both models and frameworks of quality (Brady and Cronin, 2001). This thesis does not attempt to develop a new measure of internal audit quality, nor examine (discredit) the veracity of the measure based on external audit standards. Instead, an objective is to identify quality determinants viewed by multiple key stakeholders that may then be applied in the development of a new measure in future research.

Within the extant IAF quality literature, the focus has remained on the role of the IAF in external financial reporting. This financial perspective of internal audit limits the insights into IAF quality (Gramling et al., 2004). Many authors note the changing role of the IAF beyond an ‘extension’ of the external audit to a function which now provides a variety of services to a greater range of stakeholders (Anderson et al., 2012b; Carcello et al., 2005; Desai et al., 2010; Gramling et al., 2004; Munro and Stewart, 2010; Sarens, 2009; Strand Norman et al., 2010). The definition of internal auditing provided by the Institute of Internal Auditors (IIA) supports the view that an IAF is more than simply an activity concerned with assurance of financial controls:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. (IIA 2013)

Further, the IIA states that the primary stakeholders of the IAF are the audit committee, the board, management and audit clients (IIA 2010). The way these stakeholders judge

IAF quality and their reliance on the IAF has generally not been addressed in the literature. Differences may exist among various governance stakeholders' views as each stakeholder has different and diverse needs and views compared to the external auditor (Cohen et al., 2004). Judgments on quality can differ amongst stakeholders depending on their relationship with the other party and the lens through which they judge quality (Aguilera et al., 2008; Cohen et al., 2013b; Gramling et al., 2004; ICEAW 2010; IAASB 2011; Lampe and Sutton, 1994). Another stakeholder is internal auditors themselves (IIA 2010), who again have had limited focus in extant IAF quality research. Gramling et al. (2004) identify that research on IAF quality assessment is heavily concentrated on external auditor assessments and encouraged researchers to focus on how other governance parties assess IAF quality; to date, this call has largely gone unaddressed. Given internal audit's evolved role and multiple stakeholders, it is imperative to understand IAF quality from different perspectives. Failure to understand how the main IAF stakeholder's (the multiple users and providers) judge IAF quality and the factors they consider determinants of a quality IAF is a major obstacle in producing greater IAF quality.

1.3 RESEARCH QUESTIONS

The overarching research question of this thesis is 'What is IAF quality?'. The objective of answering this question is to provide a comprehensive framework to improve our understanding of IAF quality, expand the conceptual base of the existing literature on IAF quality beyond its limited scope and provide a platform to build context specific models of IAF quality to enable future research including both archival and experimental research.

Based on a multi-disciplinary review within business and social psychology literatures that measure quality of services and tasks, this thesis develops a theoretical

framework of IAF quality. The framework suggests IAF quality consists of multiple dimensions including inputs, processes, outputs, outcomes, and contextual dimensions. Each dimension is likely comprised of many potential factors. Based on this theoretical framework, this thesis attempts to expand prior IAF quality research (Desai et al., 2010; Lin et al., 2011; Prawitt et al., 2012; Prawitt et al., 2009) in three ways. First, by identifying how IAF stakeholders, besides the external auditor, judge IAF quality. Second, identifying the main information cues IAF stakeholders use in their assessments of IAF quality. Third, identifying the key factors IAF stakeholders consider as necessary to create high quality IAFs. Therefore, to understand the construct of IAF quality, the following research questions are addressed:

RQ1: Do different IAF stakeholder groups judge IAF quality differently?

RQ2: What are the main information cues used by IAF stakeholders to judge IAF quality?

RQ3: What input, process, output, and contextual factors are considered by IAF stakeholders as determinants to the quality of an IAF?

The thesis explores two related perspectives on the drivers of IAF quality: firstly, how stakeholders judge the quality of an IAF; and secondly, what factors are considered influential determinants of a quality IAF. RQ1 and RQ2 consider the first perspective; RQ3 considers the second perspective.

RQ1 is based on the notion that different stakeholders have different needs and knowledge bases, potentially resulting in different views and judgments of IAF quality (Aguilera et al., 2008; Cohen et al., 2010; Cohen et al., 2013b). RQ2 also considers the first perspective and explores how stakeholders make judgments on IAF quality, specifically the main information cues they use to make their judgments. This question

recognizes that in forming judgments, IAF stakeholders will weight a limited number of cues (Ashton, 1974; Libby, 1981; Tversky and Kahneman, 1974).

RQ3 addresses the second perspective and extends RQ2 by examining the range of factors considered by IAF stakeholders to be influential determinants of a high quality IAF. Thus, RQ3 attempts to identify additional factors that affect the quality of an IAF but may not be available or weighted highly in IAF quality judgments, the focus of RQ2.

1.4 CONTRIBUTIONS

In addressing the three research questions this thesis makes contributions to both theory and practice which are discussed below.

1.4.1 CONTRIBUTIONS TO THEORY

First, the current literature has a limited understanding of IAF quality, which is almost exclusively based on the view of the external auditor. Incorporating multiple key governance stakeholders' views into IAF quality extends the prior literature to provide a more comprehensive view of quality and moves beyond understanding and measuring IAF quality in the context of its role in external financial reporting. This thesis supplements existing research by identifying that a quality IAF is important to IAF clients and their organisation, IAF quality is multi-dimensional, there are contextual factors influencing the ability of an IAF to be of high quality, and that the factors used for making judgment of IAF quality differ between stakeholders.

Second, prior literature has identified the importance of research in identifying what management and audit committees expect from the IAF in their role as a governance resource, and what they are actually being provided (Gramling et al., 2004).

This thesis addresses this question based on evidence provided from a very experienced group of participants' descriptions of their own organisations.

Third, this thesis develops and investigates a theoretical framework of IAF quality based on theory from other disciplines conceptualising the quality of services or tasks. The framework captures a broader range of quality influencing dimensions and factors over the current factors in IAF quality literature based on internal auditor attributes. While this thesis does not develop a specific measurement instrument, this framework may be used for IAF quality measurement. It provides a more holistic view of the entire IAF service and the multi-stakeholder perspective provides researchers with a more comprehensive set of factors affecting quality.

Fourth, the findings of this thesis provide opportunities for future research of IAF quality based on findings that suggest judgments of quality differ across professional roles and stakeholders consider a much larger collection of factors in IAF quality assessment than currently known. The findings provide a platform for empirical testing of organisations' IAF quality and their relationship with various firm outcomes. In doing this, this thesis extends recent research that has modelled IAF quality for external auditor reliance decisions (Desai et al., 2010) and research that has developed composite measures of IAF quality (Lin et al., 2011; Prawitt et al., 2009). The insights from interviews about the factors that affect IAF quality provide the opportunity for experimental research to examine, in a controlled setting, the conditions under which the factors affect IAF quality and further insights into the reasons for these effects.

Fifth, a salient feature of this research is that attributes of quality are identified by users and preparers of internal audit based on their experiences, in contrast to factors prescribed by a set of mandatory standards. This thesis also introduces a field research method to examine IAF quality beyond surveys, experiments and analytical models.

Further, this thesis engages with a very different group of practitioners (audit committee members, senior management, and in-house internal auditors) from some of the largest Australian companies, along with partners of internal audit divisions from the major accounting firms (each Big 4 and one second tier firm) to better understand the factors that affect IAF quality and judgments of IAF quality by these stakeholders.

Sixth, this thesis also makes a potential contribution outside of the internal audit field to the broader quality measurement literature and the body of conceptual quality frameworks. For instance, accounting institutions are investing considerable effort in the development of external audit quality frameworks (e.g. FRC 2008; IAASB 2011; KPMG 2010). Whilst not assessing external audit quality, the results of this thesis contribute a new way of determining important quality factors and support the appropriateness of current external audit quality frameworks in including multiple dimensions, stakeholders and outside forces.

1.4.2 CONTRIBUTIONS TO PRACTICE

The contribution to practice is important to corporations that employ internal audit, users of internal audit information, providers of internal audit services, the standard-setting and regulatory bodies including the IIA and corporate governance regulators. A multi-stakeholder framework of IAF quality, providing an understanding of views from each of the IAF stakeholders, can benefit each of these stakeholders. The contribution to these groups is outlined below.

First, a greater understanding of IAF quality is important for improvements in quality and enhancing the internal audit service (Gramling et al., 2004). Organisations and the users of IAF services should be interested in the quality of their IAF, and how to improve their IAF, as IAF information is important to users' decisions and considerable resources are devoted to the IAF. Gaining an understanding of factors that multiple

users of internal audit perceive to influence IAF quality will provide important insights on how organisations can improve IAF quality. Considering the quality of their IAF is important to determine where to direct and focus efforts for improvement; low quality functions may require changes such as restructuring, refocus or change of sourcing arrangement, or more generally, exploring ways to improve the service.

Second, specific users of internal audit services will be provided with an understanding of other users' views of quality which can be incorporated into their decisions and demands on the IAF to alleviate some tension between the two parties who often have competing demands of the IAF (Abbott et al., 2010). Further, the IAF quality framework can guide audit committees to develop and oversee quality IAFs, or evaluate proposals from outsourced providers, to provide the greatest possible value and satisfy the demands of each stakeholder. The framework can also aid audit committees, senior management and others in the organisation undertaking formal assessment of IAF quality.

Third, internal audit providers will be more informed about how their clients judge IAF quality, what these clients consider important factors of quality, and requirements for IAF quality performance. An understanding of how these factors differ among stakeholders can aid internal audit providers to deliver high quality audits and how to best serve each of their clients to provide maximum value.

Fourth, the results of this study may also provide insights and guidance to regulators and standard setters, such as the IIA who set the international standards for internal auditing, and corporate governance regulators who recommend or require firms to maintain an IAF. In determining regulation and setting standards, it is important to consider ways to improve internal audit from a multi-stakeholder perspective.

1.5 ORGANISATION OF THE THESIS

Chapter 2 provides background information on the IAF as a corporate governance mechanism, reviews prior literature investigating and/or measuring IAF quality, develops a theoretical framework of IAF quality based on an interdisciplinary review of quality measurement, and discusses the research questions in greater detail. Chapter 3 discusses the methodology employed to undertake this multi-stakeholder investigation. Chapter 4 presents the findings and discussion for RQ1 and RQ2. Chapter 5 presents the findings and discussion for RQ3. Chapter 6 provides the conclusions for this thesis.

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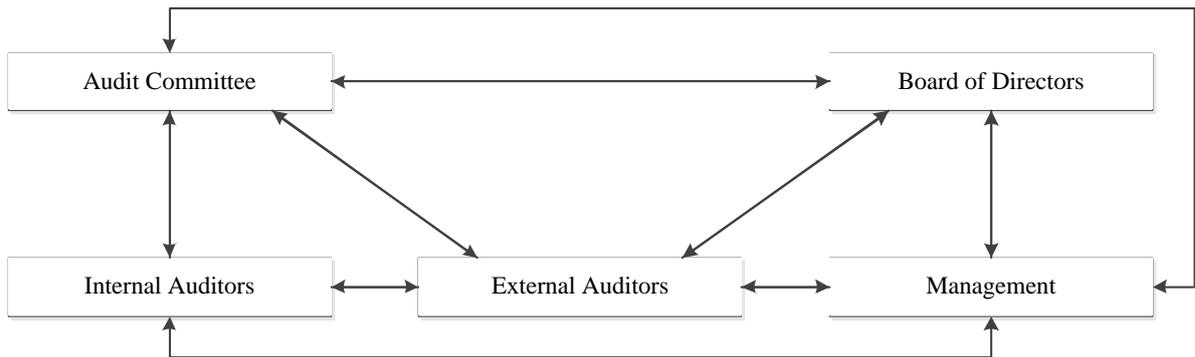
This chapter begins by providing an overview of the IAF within the corporate governance mosaic and the IAF's relationships with other internal governance stakeholders as a background to this research. The second section presents a review of IAF quality research and identifies the necessity of furthering the extant literatures' understanding of IAF quality and improving IAF quality measurement. Due to the

identified limitations of IAF quality research, the third section presents an interdisciplinary review of related disciplines that conceptualise the construct ‘quality’ for services or tasks. Through integrating these literatures, two key insights into conceptualising quality are identified: first, quality is a consumer perspective, and second, quality is multi-dimensional. Sections 2.4 and 2.5 address these insights and a theoretical framework of IAF quality is developed for multiple stakeholders. The following section revisits the research questions in light of the proposed theoretical framework. The final section of this chapter provides a synthesis of corporate governance theories that will be used to help explain judgments of IAF quality by the IAF stakeholders.

2.1 INTERNAL AUDIT AND CORPORATE GOVERNANCE

The internal audit function (IAF) is an integral component within corporate governance (Anderson et al., 2012b; Archambeault et al., 2008; Desai et al., 2010; Glover et al., 2008; Prawitt et al., 2009). Cohen et al.’s (2004) model of corporate governance includes internal audit as one of five internal governance stakeholders along with the audit committee, management, external auditors and the board of directors. Their model, depicted in Figure 1, identifies that the IAF has direct relationships with the audit committee, senior management and external auditors, and only an indirect relationship with the board of directors. The interactions among the IAF and the other governance stakeholders are crucial to effective governance (Cohen et al., 2004; Gramling et al., 2004).

Figure 1: Internal Governance Stakeholders



Note: Adapted from Cohen et al. (2004).

Similarly, the Institute of Internal Auditors' (IIA) (2003) models the IAF as one of four cornerstones of high quality corporate governance along with the audit committee, senior management and the external auditors. The main difference between these two models is Cohen et al. (2004) have included the board of directors along with a board sub-committee – the audit committee. This thesis focuses on the audit committee as the representative of the board of directors, as the IAF actively serves the board through the audit committee (IIA 2011a; Moeller, 2009).

2.1.1 IAF AND GOVERNANCE STAKEHOLDERS

The IAF is a resource to the other internal governance stakeholders (shown in Figure 1) providing these stakeholders information from assurance and consulting activities to help fulfil their duties (Gramling et al., 2004; Moeller, 2009; Ramamoorti, 2003; Ruud, 2003). This thesis focuses on the audit committee, senior management and external auditors as the three key internal corporate governance stakeholders of the IAF and collectively refers to them as 'users' of the IAF, whilst internal auditors are referred to as 'providers'. Together, the 'users' and 'providers' are collectively referred to in this thesis as 'IAF stakeholders'. The following sections outline the primary role the IAF

provides to the three internal governance stakeholders. These relationships are important as they establish the multiple ways stakeholders use the IAF.

IAF and the Audit Committee

Audit committees rely on the IAF as a primary resource to execute their duties and meet their governance mandate (Abbott et al., 2010; Blue Ribbon Committee, 1999; Gramling et al., 2004; Raghunandan et al., 2001; Treadway Commission, 1987). The IAF provides assurance to the audit committee over areas including compliance, financial reporting integrity and internal control, and provide investigations of fraud and organisational governance (Abbott et al., 2010; Beasley et al., 2009; Cohen et al., 2004; Gramling et al., 2004; Hermanson and Rittenberg, 2003; Scarbrough et al., 1998). Audit committees also receive comfort from internal audit's consulting role in internal control improvements (Sarens et al., 2009). An IAF can also develop an accountability relationship between the audit committee and management helping to reduce information asymmetry (Gendron and Bédard, 2006) resulting from the audit committee's separation from the operations of the organisation.

IAF and Senior Management

The IAF is an influential part of senior management's role (Moeller, 2009). The IAF provides assurance to management over the effectiveness of risk management processes, evaluation of internal controls, and operational processes (Abbott et al., 2010; Gramling et al., 2004; Hermanson and Rittenberg, 2003). Internal audit also supports management by providing consulting services to facilitate the improvement of controls, processes and operations, (Arena and Azzone, 2009; Hermanson and Rittenberg, 2003; Ramamoorti, 2003; Sarens and De Beelde, 2006) and assist management in achieving operational goals and generating cost savings (Abbott et al., 2010; Anderson, 2003; Hermanson and Rittenberg, 2003).

IAF and the External Auditor

External auditors use the work of the IAF in planning and obtaining evidence that can modify the nature, timing and extent of audit procedures. Under external audit standards, the external auditor can use the work of the internal auditor in two ways: through relying on work already performed by the IAF, or, using the IAF as direct assistants in audit tasks. The work of the IAF is relevant when the nature of the IAFs responsibilities and actions are related to financial reporting (IFAC 2009b, 2009c). Reliance on the IAF affects both the efficiency and effectiveness of the external audit. Efficiency can be improved as external audit work can be reduced (Messier et al., 2011) through, for example, lower substantive testing, and is evident through a reduction in audit fees (Abbott et al., 2012; Felix et al., 2001) and audit delays (Pizzini et al., 2012). Audit effectiveness can be improved as the work of the IAF can provide higher levels of assurance over the integrity of financial statements. For example, the IAF has been found to improve detection and reduce detection risk by increasing audit coverage (Coram et al., 2008; Lin et al., 2011; Prawitt et al., 2012; Prawitt et al., 2009) and act as a deterrent to financial reporting irregularities and aggressive accounting behaviour (Lin et al., 2011; Prawitt et al., 2009).

In summary, the three internal governance stakeholders (users) of the IAF have overlapping demands on the IAF, however, many demands are unique to particular users. As IAF users have competing/conflicting objectives (Abbott et al., 2010; Raghunandan et al., 2001) each user is likely to exert pressure on the IAF to undertake activities that best align with their needs (Sutton and Lampe, 1991). For example, the IAF often needs to balance the demands of the audit committee and senior management in their role of 'serving two masters' (Abbott et al., 2010). The value of the IAF's relationship with the users is contingent on the quality of the IAF (Gramling et al.,

2004). Different demands on the IAF likely result in different perceptions of IAF quality for the different users. The three internal governance stakeholders also have an incentive to evaluate IAF quality and ensure that it meets their particular needs. To add value to users, the IAF must be of sufficient quality given the particular demands of the three internal governance users.

2.2 IAF QUALITY RESEARCH

Gramling et al. (2004) provide a comprehensive review of IAF quality research and note that “the literature on IAF quality has almost exclusively been examined from the view of the external auditor” (Gramling et al., 2004, p. 210). Suggesting this is an issue, they encourage research to focus on how other parties assess IAF quality, determinants of quality and potentially expand measures of quality. Recent IAF quality research, summarised in Table 1 (see Appendix A for a detailed review), can be divided into two focal areas: (1) IAF quality and actual firm outcomes (such as reduced earnings management and accounting risks); and (2) IAF quality and external auditors’ reliance on the IAF. Collectively, results of these studies emphasize the importance of high IAF quality. With only the one exception,³ this research finds that high IAF quality improves both firm outcomes (Lin et al., 2011; Prawitt et al., 2012; Prawitt et al., 2009) and increases external auditor reliance (Desai et al., 2011; Felix et al., 2001, 2005; Glover et al., 2008; Krishnamoorthy and Maletta, 2008; Messier et al., 2011; Pizzini et al., 2012).

³ Kaplan and Schulz (2007) did not find a relationship between IAF quality and the intention of employees to use the IAF as a whistle-blowing channel.

Table 1: Findings from Studies Investigating IAF Quality

Authors	Main findings
<i>IAF Quality and Firm Outcomes</i>	
Prawitt, Smith & Wood (2009)	IAF quality plays an important role in the quality of external financial reporting as higher IAF quality moderates earning management.
Prawitt, Sharp & Wood (2012)	Higher IAF quality is positively associated with lower accounting risk (misleading or fraudulent financial reporting).
Lin, Pizzini, Vargus & Bardhan (2011)	Various measures of IAF quality are positively associated with material weakness (MW) disclosures. IAF activities performed (nature and scope) are more strongly associated with disclosures of MW than the IAF attributes competence, objectivity and investment in the IAF. The attribute, education level, is strongly associated with MW disclosure.
Kaplan & Schulz (2007)	Higher IAF quality is not associated with greater likelihood of using the IAF as an anonymous reporting (whistle-blowing) channel.
<i>IAF Quality and the External Auditors' Reliance Decision</i>	
Messier, Reynolds, Simon & Wood (2011)	External auditors assess IAF quality lower and place less reliance on the IAF when the IAF is used as a management training ground (MTG), as internal auditor objectivity is assessed to be lower than when the IAF is not used as a MTG.
Felix, Gramling & Maletta (2001)	Investigated four factors (IAF quality; availability of internal audit; coordination between the IAF and the external auditor; level of risk in the external audit) and found that IAF quality was the greatest determinant in IAF contribution to the external audit. Also, external auditor reliance is positively associated to IAF quality regardless of inherent risk
Felix, Gramling & Maletta (2005)	IAF quality affects the external auditor reliance decision when the external audit does not provide non audit services (NAS) to the client. However, client pressure outweighs IAF quality in the external auditor reliance decision when the external auditor provides NAS to the client.
Krishnamoorthy & Maletta (2008)	An external auditors' assessment of IAF quality is greater when there is greater audit committee expertise and when the external auditor perceives greater governance strength of the audit committee.
Desai, Gerard & Tripathy (2011)	Co-sourced and outsourced IAFs are equal in IAF quality and external auditors rely more on co-sourced and outsourced IAFs (than in-house IAFs) as they are viewed of having greater IAF quality. IAF quality only affects reliance for high risk areas of the external audit.

Authors	Main findings
Glover, Prawitt & Wood (2008)	The sourcing arrangement of the IAF significantly affects the external auditor reliance decision. In-house and outsourced IAFs are assessed to have no difference in internal auditor competence, but a significant difference in internal auditor objectivity and therefore IAF quality is assessed lower for in-house IAFs due to their lower objectivity.
Pizzini, Lin, Vargus & Ziegenfuss (2011)	IAF quality is negatively associated with external audit delay suggesting external auditor effort is reduced with IAF quality due to lower control risk.
Desai, Roberts & Srivastava (2010)	Modelling the external auditor reliance decision process for IAF quality, these authors identify the importance of, and interrelationships between, the three external audit factors (competence, objectivity, work performance). Identified an IAF quality assessment will be low when there is no information on objectivity, and audit committee quality significantly impacts IAF quality.

However, consistent with the observation by Gramling et al. (2004), this recent research has primarily focused on the external auditors' views of IAF quality and IAF quality's impact on financial reporting activities (with the exception of Kaplan and Schulz 2007). The confined scope of prior research to this single IAF user and stakeholder of corporate governance, and single IAF activity is inconsistent with contemporary IAFs. An IAF serves each of the stakeholders outlined in Figure 1, yet little consideration has been given to these other stakeholders and how they assess quality. The IAF also perform a variety of assurance and consulting activities beyond assurance over financial controls. Closely related to this scope issue is how this literature has measured and contextualised IAF quality; research has consistently based IAF quality measures on 'three factors' provided in a prescriptive model of IAF quality advocated in external audit standards. These three issues will be discussed in the following sections.

2.2.1 CHANGING ROLE AND RELATIONSHIPS OF THE IAF

Considerable research documents the evolving role of internal audit (for example Ahlawat and Lowe, 2004; Burton et al., 2012; Carcello et al., 2005; Cohen et al., 2010; Ernst & Young, 2011; Gramling et al., 2004; Gramling et al., 2012; Moeller, 2009; Ramamoorti, 2003). Traditionally, the IAF was considered an extension of the external audit, primarily focused on financial controls. In the 1990s, internal audit expanded from this narrow scope to a broader, more evaluative focus including operational, management, financial and compliance auditing (Gramling et al., 2012; Moeller, 2009; Ramamoorti, 2003).⁴ In response to changing business needs, business processes becoming more complicated, and a need for business improvement, internal audit has

⁴ For an in-depth history of the internal audit function, see Moeller (2009) or Ramamoorti (2003).

again recently broadened its scope to its current remit of an assurance and consulting focus over risk management, control and governance (IIA 2011b, p. 6; Moeller, 2009).⁵

IAFs still perform assurance over financial reporting activities and controls, however, recent practice literature supports the changing nature of the IAF role, indicating only small proportions of an IAF's time is dedicated to financial activities and this proportion is expected to decrease. For example, Allegrini et al. (2011) find 71.6% of IAFs audit financial risk and 71.2% of IAFs investigate fraud and irregularities. However, respondents in their study indicate that substantially less IAFs will perform these roles in the next 5 years (only 13% on financial risk and 13.2% on fraud and irregularities). A consistent finding was made by PricewaterhouseCoopers (PWC) where 62% of CEOs indicate their organisation's IAF focus on financial reporting and SOX related activities will decrease in the next 3 years (PWC 2011). The Allegrini et al. and PWC studies did not request data on the actual time spent on specific IAF activities. A study by Protiviti and IIA Australia find on average only 16% of an entire IAF's role is dedicated to financial activities (with another 7% of time dedicated to fraud investigations)⁶ (Protiviti, 2013). The focus on financial activities has decreased since their 2011 findings where 21% of IAF time was related to financial activities (Protiviti, 2011).

The changing role of the IAF has introduced different relationships between the IAF and corporate governance stakeholders; there are now different demands, needs and expectations by these stakeholders on the IAF (Carcello et al., 2005; Gramling et al.,

⁵ Shortly after the SOX regulation was imposed in the U.S., internal audits regained a significant focus towards assuring financial controls to help organisations with their responsibilities under this legislation. Now, as organisations are largely in compliance with SOX, IAFs have recommenced their focus on business improvement (Gramling et al., 2012).

⁶ The remaining 77% of time was spent on operational (24%), compliance (15%), risk management (11%), I.T. (11%), governance (8%), and other (8%) activities.

2004; Ramamoorti, 2003). For example, where previously the IAF was considered a monitor over management actions within financial reporting and control processes, the IAF is now also considered a partner to management as they also undertake operational audits, consulting and business improvement activities.

2.2.2 MEASUREMENT OF IAF QUALITY

The pervasive external audit perspective of IAF quality has also limited the measurement of IAF quality. Researchers have based IAF quality measures upon a prescriptive model of three factors advocated within external audit standards (AICPA 1990; IFAC 2009c; PCAOB 2007). External audit standards contend that for an external auditor to rely on internal audit work, the external auditor must exercise professional judgment in assessing IAF quality including internal auditor competence and objectivity and that the nature and scope of the work performed by the IAF is relevant to financial reporting and financial statement audits. These three external audit standard factors – competence, objectivity and work performance – are collectively referred to in this thesis as the ‘three factors’ (Appendix B provides greater discussion on the external audit standards prescription of IAF quality).

The conceptualisation of IAF quality in recent research is summarised in Table 2. As is evident from this table, research has predominantly focused on the ‘three factors’, with only a few studies including supplementary factors such as size in their measurement.⁷ Naturally, studies assessing external auditor reliance on the IAF have used the ‘three factors’; however the studies investigating IAF quality and firm outcomes (Kaplan and Schultz, 2007; Lin et al., 2011; Prawitt et al., 2012; Prawitt et al.,

⁷ International audit standards (ISA610) (IFAC 2009c) contend an external auditor must assess internal auditor competence, objectivity and due care. With the exception of Messier et al.’s (2011) experimental component of their study, studies have not included due care in the factors as a result of following U.S. AICPA and PCAOB standards.

2009) have also based their quality measurement on these standards, yet these studies have not been investigating external auditors' reliance on the IAF. Adopting the 'three factors' potentially limits the research questions addressed and the insights gained, particularly given the recent expansion in the IAF's role.

The problem is that the 'three factors' employed in IAF quality measurement to date are inputs to the IAF. However, the concept of IAF quality is likely broader than solely the quality of inputs. There are two input types: internal auditor attributes (competence and objectivity) and structural elements of the function (nature of activities and investment).⁸ Lin et al. (2011) and Pizzini et al. (2012) expand beyond the 'three factors' and include a fieldwork component in their respective measures.⁹ The problem with focusing solely on inputs to assess quality is that other critical factors that may affect quality are not considered.

⁸ Work performance by its nature may not be termed an input or attribute of the function, however, IAF quality studies have operationalized work performance as time spent on specific activities related to external financial reporting (as seen in Table 2).

⁹ Lin et al. (2011) and Pizzini et al. (2012) note their measures are based on both external audit standards and internal audit standards.

Table 2: Conceptualisation of IAF Quality

	External Audit Standards ‘Three Factors’ of IAF Quality			Additional Factors
	Competence	Objectivity	Work Performance	
Prawitt, Smith & Wood (2009)	<ul style="list-style-type: none"> • Experience • Certification • Training 	<ul style="list-style-type: none"> • Reporting Relationship 	<ul style="list-style-type: none"> • Focus on financial work 	<ul style="list-style-type: none"> • Investment in the IAF (relative)
Prawitt, Sharp & Wood (2012)	<ul style="list-style-type: none"> • Experience • Certification • Training 	<ul style="list-style-type: none"> • Reporting Relationship 	<ul style="list-style-type: none"> • Focus on financial work 	<ul style="list-style-type: none"> • Investment in the IAF (relative)
Lin, Pizzini, Vargus & Bardhan (2011)	<ul style="list-style-type: none"> • Experience • Certification • Training • Education 	<ul style="list-style-type: none"> • The amount of control related information the CAE reviews with the audit committee. • CAE position is an officer of the firm 	<ul style="list-style-type: none"> • Focus on financial reporting • Use of quality assurance techniques in fieldwork • Inclusion of grades or summary opinions on control effectiveness in audit reports. • Follow-up of previously identified control problems • Coordination with external auditors 	<ul style="list-style-type: none"> • Investment in the IAF (relative)
Kaplan and Schulz (2007)	<ul style="list-style-type: none"> • Certification 	<ul style="list-style-type: none"> • Reporting Relationship • IA compensation 	<ul style="list-style-type: none"> • Financial oversight vs. Business consulting 	<ul style="list-style-type: none"> • Investment in the IAF
Messier, Reynolds, Simon & Wood (2011) (<i>Archival</i>)	<ul style="list-style-type: none"> • Experience • Certification • Training 	<ul style="list-style-type: none"> • Reporting Relationship 	<ul style="list-style-type: none"> • Focus on financial work 	<ul style="list-style-type: none"> • Investment in the IAF (relative)
Messier, Reynolds, Simon & Wood (2011) (<i>Experimental</i>)	<ul style="list-style-type: none"> • Competence 	<ul style="list-style-type: none"> • Objectivity 		<ul style="list-style-type: none"> • Due Care

	External Audit Standards ‘Three Factors’ of IAF Quality			Additional Factors
	Competence	Objectivity	Work Performance	
Felix, Gramling & Maletta (2001)				<ul style="list-style-type: none"> External auditor assessment of overall IAF quality ^a
Felix, Gramling & Maletta (2005)				<ul style="list-style-type: none"> External auditor assessment of overall IAF quality ^a
Krishnamoorthy and Maletta (2008)				<ul style="list-style-type: none"> External auditor assessment of overall IAF quality ^a
Desai, Gerard & Tripathy (2011)	<ul style="list-style-type: none"> Competence 	<ul style="list-style-type: none"> Objectivity 		<ul style="list-style-type: none"> Technical Skills
Glover, Prawitt & Wood (2008)	<ul style="list-style-type: none"> Competence 	<ul style="list-style-type: none"> Objectivity 		
Pizzini, Lin, Vargus & Ziegenfuss (2012)	<ul style="list-style-type: none"> Experience Certification Training Education 	<ul style="list-style-type: none"> Reporting Relationship 	<ul style="list-style-type: none"> Focus on financial work 	<ul style="list-style-type: none"> Investment in the IAF (relative) Fieldwork Quality Assurance (6 factors)
Desai, Roberts & Srivastava (2010)	<ul style="list-style-type: none"> Experience Certification Training Audit planning & supervision 	<ul style="list-style-type: none"> Reporting relationship Breadth & depth of investigatory scope Recommendation implementation 	<ul style="list-style-type: none"> Effort Execution of plan Thoroughness & quality of reporting 	

^a Subjective assessment by an external auditor of the overall quality of IAF (0 = very low to 100 = very high)

Consider a scenario with two firms, Firm A and Firm B, which are of equal size. Firm A has 10 internal auditors, all of whom are professionally certified. Their Chief Audit Executive (CAE) has 20 years' experience in internal audit within the firm and the average IAF staff experience is four years. The IAF reports functionally to the audit committee chair and administratively to the CFO. The IAF spends 30% of its time on financial reporting assurance and has a budget of \$X. Firm B's IAF has the same characteristics. Based on the conceptualisation of quality in IAF literature, an assessment of IAF quality would suggest the IAFs of Firm A and B are of equal quality. However, while Firm A and B might have the same inputs this does not mean that they adopt the same processes in conducting their internal audit. It is reasonable to expect there will be differences among internal auditor's judgments and decision making (JDM). Similarly, the outputs of the IAF, such as their findings, are also likely to differ. While high quality input factors should correlate with higher quality processes and outputs, this does not automatically follow. The same inputs could be associated with different processes, auditor JDM, and outputs; thereby, resulting in potentially different levels of IAF quality. This simple example demonstrates that quality measurement focusing solely on inputs potentially limits the ability to fully explain variability in IAF quality.

This broader perspective proposed finds support in research that examines how external auditors' reliance on the IAF is impacted by factors other than input characteristics. External auditors' reliance decisions are affected by contextual factors such as client pressure (Felix et al., 2005); inherent risk (Glover et al., 2008; Maletta, 1993; Maletta and Kida, 1993); audit committee quality (Cohen et al., 2007a; Krishnamoorthy and Maletta, 2008); and IAF involvement in consulting activities (Brandon, 2010; Munro and Stewart, 2010) (see Appendix A for a greater discussion).

These findings support the idea that other factors besides inputs to the IAF affect assessments of IAF quality by the external auditor and therefore current measurement of IAF quality may not be capturing all important elements.

2.2.3 DRIVERS OF IAF QUALITY MEASURES

To progress the literature it is useful to consider the drivers behind the narrow focus of the extant literature. There are two potential reasons for the dependence on the ‘three factors’ as the basis of IAF quality measurement in much of the prior research. Firstly, the cumulative nature of research means that established measures become entrenched. Secondly, theoretical underpinnings tend to dominate to the exclusion of alternative theoretical perspectives. As a prelude to improving our understanding of IAF quality these two drivers are explored in detail.

The first driver is that the ‘three factors’ are the generally accepted measure in the literature and have been the basis of IAF quality measurement since early measurement of this construct (see reviews by Gramling et al. 2004 and Bame-Aldred et al. 2013). The pervasive adoption of the ‘three factors’ from the external audit standards is not that surprising given that the majority of IAF quality research has focused on external auditors and their reliance on the IAF. A problem is that the core professional guidance for an IAF stakeholder to assess IAF quality is prescribed by the external audit standards. The IIA provide some guidance on IAF quality; however, this guidance is largely designed for internal auditors to assess quality, and not that of other IAF stakeholders. The IIA suggest a quality internal audit is achieved through conformance to the International Standards for the Professional Practice of Internal Auditing (referred to hereafter as IIA standards), their code of ethics, and through meeting stakeholder

expectations (IIA 2010).¹⁰ The implication here is that any overt direction to assess quality is based on conformance to IIA standards and ethics. However, in practice, conformance to IIA standards is quite low. Bailey (2011) reports that 46% of IAFs conform to IIA standards, and a study by Protiviti (2011) finds only 31% of IAFs conform. Under IIA prescriptions of IAF quality, this would indicate that the majority of IAFs are not of high quality, but the more telling message is that within practice, if IAFs are not conforming to IIA standards, the standards are not a strong guidance to assess quality. Effectively the external audit standards are really the only descriptive model of IAF quality available for the multiple IAF stakeholders, and as the ‘three factors’ have become a generally accepted measure in the literature, it is not surprising that this measurement has been adopted in subsequent IAF quality research.

The second driver is the theoretical underpinning adopted. IAF quality research has explicitly, or implicitly, adopted one of two theoretical perspectives: agency theory or source reliability. The ‘three factors’ have a theoretical basis consistent with propositions of agency theory under a corporate governance view and theory on source reliability under a social psychology view. Both of these views focus on attributes of the service provider. Under agency theory, implementing monitoring mechanisms attempts to align manager’s interests with principals and reduce information asymmetry (Fama and Jensen, 1983; Jensen and Meckling, 1976). With the traditional perspective of the IAF as a monitoring mechanism providing assurance over financial controls and financial reporting, viewing the IAF via an agency perspective is warranted. Agency theory considers independence and expertise as the central attributes of a monitor (Cohen et al., 2008; Hermanson et al., 2012). Under a monitoring perspective of the

¹⁰ Greater discussion on IIA standards and IIA guidance in relation to IAF quality is provided in Appendix C.

IAF, the two factors, objectivity and competence, map very closely to these two attributes.¹¹ The third factor, work performance, operationalized by the nature and scope of activities performed is also important to consider as an external auditor is only concerned with IAF work pertaining to the financial statement audit (Messier et al., 2011).

An alternative is to look at the ‘three factors’ from a source reliability theoretical foundation. An external auditor is required to obtain an understanding of the reliability of sources of information (IFAC 2009b). In the external auditors’ decision to use the work of the IAF, reliability of the information produced by the work of internal audit is a major concern (Krishnamoorthy, 2001; Maletta, 1993); inaccurate judgments of reliability may result in inappropriate decisions by the external auditor based on the work of the IAF (Edge and Farley, 1991). Psychology research indicates source reliability influences an individual’s perception of the pervasiveness of information, and ultimately their acceptance or level of use of that information (Birnbaum and Stegner, 1979; Chaiken and Maheswaran, 1994; McGinnies and Ward, 1980). When quality is difficult to assess the focus turns to input factors of the sources where the assessor evaluates information via its source credibility¹² and trustworthiness (O’Reilly, 1982) rather than processes or outputs. The source reliability research noted above identifies two dimensions of source reliability: source expertise and source bias. Source expertise is the perceived ability of the source to provide information of an actual or true nature, and source bias refers to motivating influences on the source to misreport or distort

¹¹ Bonner and Lewis (1990) state that experience and competence should not be confused with expertise. Libby and Luft (2002) report experience, knowledge, ability and performance are the four attributes of expertise; therefore competence and experience are only a part of expertise. For example, Bonner and Lewis (1990) find experienced external auditors do outperform inexperienced external auditors but variation can also be explained by the innate ability of the person. While competence and experience are attributes of expertise, these attributes must be brought to bear on a task (Davis and Solomon, 1989).

¹² The terms ‘source reliability’ and ‘source credibility’ are used interchangeably (Rebele et al., 1988).

information. The two dimensions of source reliability can be mapped to the ‘three factors’; source expertise has been operationalized as competence and work performance, and source bias operationalized as objectivity (Goodwin, 1999).

2.2.4 SUMMARY OF IAF QUALITY RESEARCH

This section has highlighted how the confined scope of prior research on IAF quality may be limiting the understanding of this important component of corporate governance. Research has been limited to one IAF user, the external auditor, and has largely neglected other stakeholders within the corporate governance mosaic. Likewise, research has focused on the internal audit role within financial reporting and has overlooked other internal audit activities. As such, research on IAF quality has not contemporaneously progressed with the evolution of internal audit practice. Relatedly, measures of IAF quality have been based on external audit standards which may be a reflection of an agency theory perspective or a source reliability perspective, both which focus on inputs to the function. Furthermore, the external audit standards are the only descriptive model available to multiple stakeholders for guidance on assessment of IAF quality. To address these issues and enhance the literatures’ understanding of IAF quality, this thesis takes an interdisciplinary approach and looks at the conceptualisation of quality in related business disciplines and organisational psychology for theory and measurement to aid a framework of IAF quality.

2.3 ALTERNATIVE CONCEPTUALISATIONS OF QUALITY

This section draws on literature from multiple business and social psychology disciplines with established conceptualisations on quality measurement. These disciplines identify that various customers (clients) may have different views on quality and that both the customers and the service or task provider may judge the quality of a service or task differently. Drawing common elements from this interdisciplinary

approach enables a foundation for the development of a framework of IAF quality. The following disciplines are reviewed: external audit, information systems; service quality; internal service quality; team performance and collective judgments. The key insight from the review is that quality is a multi-dimensional construct.

2.3.1 EXTERNAL AUDIT QUALITY

Numerous attempts have been made to define external audit quality, however none have gained universal recognition or acceptance (IAASB 2011; Watkins et al., 2004). Reasons for this include that external audit quality perceptions vary between stakeholders, there is often no unambiguous correct answer for an external audit, and there is little transparency in the external audit process which makes assessment difficult (Peecher et al., 2013). Much of the archival external audit quality literature relies on DeAngelo's definition of external audit quality as "the market-assessed joint probability that a given auditor will *both* (a) discover a breach in the client's accounting system, and (b) report the breach" (DeAngelo, 1981, p. 186). There are two components to this definition; external audit quality is a function of the market's perception of (a) auditor competence and (b) auditor independence. Important here is the term 'market perception' which infers that external audit quality is not simply the function of auditor competence and independence but the markets perception of the auditor's reputation.

External audit quality is typically unobservable and users typically cannot observe, or communicate with the external auditor (Francis, 2004, 2011; ICEAW 2010; Smith, 2012). As a result, archival external audit literature has identified a number of surrogate measures to assess external audit quality indicating differences between audits based on Big X/Non Big X providers, industry expertise, external audit firm and partner tenure, external audit fees, and litigation (Francis, 2011). Francis (2011) developed a framework for external audit quality under a supply driver perspective and suggests

external audit quality is affected at each level of analysis within the framework. The framework consists of the following units: audit inputs, audit process, accounting firms, audit industry and audit markets, institutions, and economic consequences of audit outcomes.

Another stream of external audit quality research is based on auditor judgment and decision making (JDM) which takes a different perspective to the archival external audit quality literature. The basic premise of the JDM audit literature is that the quality of external auditor judgments influences the quality of the external audit and as such treats auditor JDM quality as external audit quality (Peecher et al., 2007). This literature attempts to understand and evaluate external auditors' performance and judgments – how good is their performance, how good are their judgments, and how can these be enhanced to improve the external audit process (Libby and Luft, 1993; Nelson and Tan, 2005; Solomon and Trotman, 2003).

A number of professional frameworks on external audit quality also exist. The Financial Reporting Council (FRC) audit quality framework identifies the following five key drivers of external audit quality: the culture within an audit firm; the skills and personal qualities of auditors; the effectiveness of the audit process; the reliability and usefulness of audit reporting; and factors outside the control of auditors affecting audit quality (FRC 2008). The International Auditing and Assurance Standards Board (IAASB) view audit quality in terms of inputs, outputs and contextual dimensions (IAASB 2011). Important aspects of the three dimensions include: *inputs*: audit standards, auditor attributes, and the audit process; *outputs*: the audit report and communication to those charged with governance of the client firm; and *contextual factors*: soundness of corporate governance, regulation and regulatory oversight, and a quality financial reporting framework. Within the accounting firms, there is a similar

view to external audit quality. For example, KPMG (2008) view external audit quality as a combination between their seven drivers of audit quality (mapped to the FRC framework) and their people: individual auditor's commitment, professional judgment, skepticism and technical competence.¹³

In summary, external audit quality is measured somewhat differently within each of the archival, JDM and professional audit quality frameworks. The diversity in views of external audit quality drivers demonstrates that quality even within a sub-discipline is not uni-dimensional.

2.3.2 INFORMATION SYSTEM QUALITY

Information system literature views the quality of information as contextual (Stvilia et al., 2007); that is, quality is determined, impacted and measured depending on the intended use of the information. This is because information users make decisions in different environments, and use information in different contexts and for different purposes (e.g. Jackson et al., 1997; Neely and Cook, 2011; Stvilia et al., 2007; Tayi and Ballou, 1998; Wang and Strong, 1996). The quality of data and information produced by information systems is generally measured by the following seven criteria: accuracy, timeliness, precision, reliability, currency, completeness and relevance (Neely and Cook, 2011; Wang and Strong, 1996). The attribute 'relevance' is positioned as the key to information system quality; if information is not relevant, users will not use the information and therefore the other six attributes become unimportant (Wang and

¹³ While internal and external audit have a number of similarities, such as audit techniques (Abdolmohammadi, 2012), differences between the two functions limit the use of external audit quality measures to measure the quality of the IAF. For example, there are differences in the principle party they serve; an IAF serves the board through the audit committee, and senior management; an external auditor serves the company owners (Sarens et al., 2009). Other differences include: internal and external audit standards and the conformance to standards and independence (Abdolmohammadi, 2012); and internal audit has a wider role and provides value added activities (Stefaniak et al., 2012). Outputs of the audits also differ; external audit reports are largely homogenous with standard wording. Further, many external audit quality measures, such as those outlined by Francis (2011) (discretionary accruals, material misstatements and external audit failure) do not apply to internal audit.

Strong, 1996). The attributes ‘accuracy’ and ‘completeness’ depend on user perceptions (Cappiello et al., 2003). Overall, this literature generally contends that information quality is multi-dimensional (Neely and Cook, 2011; Wang and Strong, 1996).

2.3.3 SERVICE QUALITY

The service marketing literature focuses on client perception of quality as objective measures are unavailable and because quality for one service user may be different to another user (Brady and Cronin, 2001; Johnson, 1995; Mills and Ungson, 2001; Oliver, 1993; Parasuraman et al., 1985).¹⁴ Two competing service quality perspectives have been established providing the basis for much of the proceeding service quality research. Collectively known as the American and Nordic perspectives (Brady and Cronin, 2001) both perspectives identify customer perceptions of service quality as appropriate to assess quality. The American perspective, Parasuraman et al.’s (1988) SERVQUAL model is the most commonly used measure (White, 2010) and identifies five attributes of service quality: reliability, responsiveness, empathy, assurances and tangibles. The Nordic perspective, developed by Gronroos (1984) identifies two dimensions of service quality: technical and functional quality. Technical quality is based on the output from the service, and, outcome of the service being performed; functional quality revolves around the service interactions and delivery. Both models are based on the disconfirmation paradigm (Cardozo, 1965; Oliver, 1980, 1993) which is the gap between a customer’s expectation of service quality and the level of quality received. The major difference between the two perspectives is the Nordic

¹⁴ Service quality measures were originally founded on the production quality and customer satisfaction literature (Brady and Cronin, 2001). Product quality is considered an objective measure as products can be measured by such things as tangibles, durability and defects (Garvin, 1983; Parasuraman et al., 1985) and can be easily attributable to a specific activity or provider (Kettinger and Lee, 1994). However production quality measures cannot directly transfer to service quality as there is greater ambiguity in service quality (Bowen and Jones, 1986). Services are performance orientated making them difficult to measure (Kettinger and Lee, 1994) and services have three unique features: intangibility, heterogeneity and inseparability between production and consumption (Parasuraman et al., 1985). Therefore in the absence of, or having less, objective measures, service quality is often measured via perceived quality.

perspective is a categorical measure while the American perspective is descriptive (Brady and Cronin, 2001). Brady and Cronin (2001) identified that the two perspectives are related and suggest that customer perceptions of service quality are formed via the evaluation of three factors: outcome, interaction, and environmental quality – each having multiple sub-dimensions.¹⁵

The service quality models are often criticised as they are based on gaps between the expected quality of service and that which is received; therefore, perceived quality can be high when performance is high or when expectations are low (Oliver, 1993, p. 66). Further, the service quality literature has generally been based on retail services and has largely failed to integrate into other industries (Brady and Cronin, 2001). Nevertheless, this literature identifies that quality is multi-dimensional and consists of both technical and service dimensions.

2.3.4 INTERNAL SERVICE QUALITY

Internal service manifests itself through interaction between internal customers and service providers within an organisation (Bruhn, 2003). The idea of internal customers originates from the total quality management literature (for example Deming, 1986; Ishikawa, 1985; Juran, 1989) which views organisations as linked networks of functional units (Brandon-Jones and Silvestro, 2010; Mohr-Jackson, 1991). Internal service quality, is the quality of service provided to (from) other departments within the organisation (Brandon-Jones and Silvestro, 2010; Schneider et al., 1998). Internal service quality measurement has commonly followed the service quality literature. However, transferring service quality measures (developed for external customers) to internal service quality has issues as internal customers differ from external customers.

¹⁵ Brady and Cronin (2001) found that three of the five attributes of Parasuraman et al.'s (1988) conceptualisation of service quality – reliability, responsiveness and empathy – are important to service quality but they are not determinants and are in fact sub-dimensions.

For example, internal customers generally have little choice over their service provider (Brandon-Jones and Silvestro, 2010; Lusch et al., 1992) and internal customers are also considered professional consumers who are more knowledgeable and in stronger positions to assess quality (Marshall et al., 1998). Bruhn (2003) conceptualised a generic measure of internal service quality into twelve dimensions: competence, reliability, accessibility, friendliness, reaction speed, time to provide the service, flexibility, customization, added value generated, cost-benefit ratio, transparency in services offered, and cost transparency. This multi-dimensional view of internal service quality may be an appropriate guide in building a framework for assessing IAF quality given the IAF is also an internal service (Anderson, 1983; Davis, 1991).

2.3.5 TEAM PERFORMANCE QUALITY

In the social psychology literature, the assessment of team/group performance is dominated by a systems approach model that characterises performance quality via three dimensions: inputs, processes and outputs. Early research in this area argued the systems approach was a linear progression; that is, greater input quality was causal to better quality processes, which create higher quality outputs (and in turn lead to high quality outcomes) (e.g. Hackman, 1987; McGrath, 1984; Steiner, 1972). However, recent research in this area documents that these three dimensions are linked but not causal. This is because there are interactions between the three dimensions, outputs ‘loop back’ to inform inputs and processes, inputs can be of high quality but the other dimensions are not automatically of high quality, and emergent states develop over the life of the team which interact with the three dimensions (De Dreu and Weingart, 2003; Dirks, 1999; Ilgen et al., 2005; Taggar, 2002). Ilgen et al. (2005) suggest there is also a large focus on outcomes in team performance assessment. Also within social psychology literature, Hart (1985) provided three interrelated criteria for the quality

assessment of collective judgments and decisions of teams. The criteria were: 1) the process by which the decision was made; 2) the content of the decision; and 3) the outcome of the decision. Hart argued that to assess quality, any assessment must successfully blend these three criteria. In sum, this literature also suggests that quality assessment, in a team performance context, is a multi-dimensional construct.

2.3.6 CORE INSIGHTS INTO THE CONCEPT OF QUALITY

While it is apparent that quality is assessed differently in each of these literatures, two fundamental insights are evident and consistent across the disciplines. First, quality is contextual and differs according to the perspective of the user, therefore quality is regarded as a user¹⁶ perspective. Second, quality is multi-dimensional consisting of a range of dimensions including inputs, processes, outputs, outcomes and contextual/environmental factors, each with multiple determinants. This contrasts with the focus of IAF quality research to date. These two insights are discussed in the following two sections and will be used to develop the research questions and the IAF quality framework.

2.4 QUALITY AS A USER PERSPECTIVE

The above literatures suggest that different users of a service may have different views on quality. The common theme adopted in these literatures is based on the concept of ‘fitness for use’ proposed in the manufacturing literature by Juran (1992). Juran identifies that quality is assessed by the recipient of the product [service] based on the deemed fitness for use. Therefore, the emphasis is on taking a user perspective to quality as, ultimately, it is the user who makes the judgment whether the product, service or task is fit for its intended use. Usefulness occurs when a consumer will use

¹⁶ The term ‘user’ refers to the consumer/customer of the service/task. In this thesis, the users are the audit committee, senior management and external auditors. The term ‘stakeholder’ includes both the users and the internal auditors.

information to improve their job performance (Jackson et al., 1997). As the output of a service or task is utilised by users for a variety of different purposes and in different domains, quality may be different for each user. What is a quality output for one user may be inappropriate for the intended use of another user, and therefore not regarded to be of the same degree of quality (Neely and Cook, 2011; Wang and Strong, 1996). That is, quality will be judged with regard to each users' perception according to their intended use of the output of the service or task.¹⁷ The external audit literature also identifies that different users have different perceptions on external audit quality (Carcello et al., 1992; Havelka et al., 1998; IAASB 2011; Schroeder et al., 1986; Sutton, 1993; Sutton and Lampe, 1991). Even within the internal audit literature, Lampe and Sutton (1994) identify external auditors and internal auditors have both similar and dissimilar concepts of quality factors of the IAF, and Krishnamoorthy (2002) notes assessments of IAF quality by external auditors are context specific.

Section 2.1.1 identified that the different stakeholders within corporate governance have different and sometimes conflicting views on IAF objectives, and that these stakeholders often use the IAF for different purposes. While it is likely that each of these stakeholder groups will share a common desire for a high quality IAF, with different uses of the IAF and different motivating factors, each of the stakeholders are likely to view and assess IAF quality differently. These differences may occur between the multiple users (such as the audit committee, senior management and external auditors) and/or between users and the service provider. Therefore, the first research

¹⁷ Definitions of quality by the Organisation for Economic Co-operation and Development (OECD) and the International Organisation for Standardization (ISO) support this notion of quality being a user perspective; these definitions recognise that quality is based on user perspective and needs (ISO 2004; OECD 2002).

question addresses whether different IAF stakeholders view and judge quality differently to one another and differently to that of the external auditor.

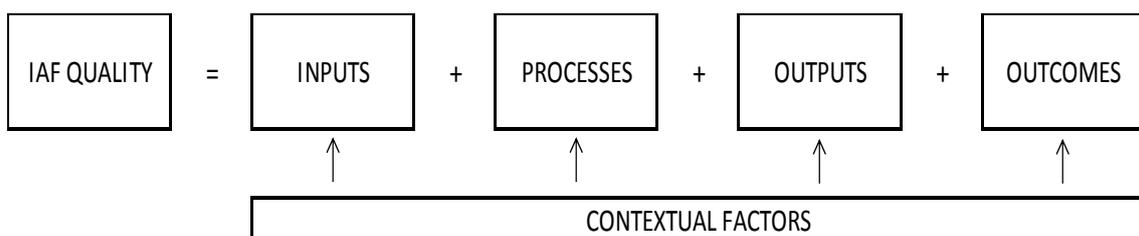
RQ1: Do different IAF stakeholders judge IAF quality differently?

2.5 MULTIPLE DIMENSIONS OF QUALITY

The inter-disciplinary review on quality conceptualisation suggests that the concept of ‘quality’ is multi-dimensional. Quality includes a range of key dimensions including inputs, processes, outputs, outcomes and contextual factors. Quality measurement often includes one, a combination, or all of these dimensions. Briefly, inputs are the people and functional aspects of the service/task; processes are the actions in performing, and decisions taken within, the service/task; outputs are the results of the service/task. Inputs, processes, and outputs are the three primary dimensions and make up ‘process-orientated models’ of quality. Outcomes are what occurs as a result of the service or task being performed; and contextual factors are factors outside the control of the service/task provider that may affect quality.

Proposed is a theoretical framework of IAF quality incorporating each of these important dimensions. The framework depicts IAF quality consisting of four dimensions: inputs, processes, outputs, and outcomes, each of which can be impacted by a fifth dimension, contextual factors. The IAF quality framework employed in this thesis is presented in Figure 2.

Figure 2: Theoretical Framework of IAF Quality



Each dimension is discussed below including how the dimension can influence a quality assessment, issues relating to solely focussing on a particular dimension and how the dimensions relate to IAF quality.

Inputs

Inputs to a service or task include the personal attributes of the service provider and the structural elements of the function, including the function's objectives and resources (IAASB 2011; Johnson, 1995; West and Anderson, 1996). A large proportion of variation in quality can be explained by input factors (West and Anderson, 1996) and inputs are regularly used to determine quality as there is an often observable positive relationship between high quality inputs and quality outputs/outcomes (Chinander and Schweitzer, 2003). However this relationship is not automatic; using input measures to proxy for output quality "is appropriate when the relationship between inputs and outputs is direct, consistent and unbiased" which in many cases these conditions do not hold (Chinander and Schweitzer, 2003, p. 243). That is, there is not always a direct relationship between input quality and output quality (ICEAW 2010). Despite this, inputs are often used in quality measures as: they are easier to measure and more readily available (therefore less costly) than process and output information; people automatically associate information about inputs (often quantities) with output quality; or when an assessor needs to justify their decision (Chinander and Schweitzer, 2003; ICEAW 2010; O'Reilly, 1982).¹⁸ Authors also identify that inputs are not always accurately measured; for example, external auditors must consider the professional competence of other external auditors when reviewing, supervising or relying on audit

¹⁸ Chinander and Schweitzer (2003) suggest there is a bias towards the use of inputs to measure output quality due to these associations; in their study they found quality judgments were affected by inputs even though participants knew inputs do not always correlate to output quality and their assessments should not be influenced by them.

work (IFAC 2009a). Research in this area has shown assessments of competence are often overconfident and sometimes inaccurate (Harding and Trotman, 2009; Kennedy and Peecher, 1997; Tan and Jamal, 2001) and this overconfidence of competency may reduce audit effectiveness or may result in inappropriate conclusions of audit reviewers (Harding and Trotman, 2009). Therefore, measuring quality via inputs only may result in inaccurate quality assessments. Also, focusing only on inputs or outputs misses the core of the function, the processes (Turnock and Handler, 1997). Nevertheless, inputs have been shown to be important in external auditor assessments of IAF quality (Gramling et al., 2004).

Processes

Processes are the actions, steps, conduct, behaviours and JDM involved in how the provider of a service/task achieves their output (Bonner, 2008; Francis, 2011; Johnson, 1995; Lampe and Sutton, 1994; Sutton, 1993). Processes are an important part of an assessment of quality as the quality of outputs and outcomes can be affected by the quality of processes. For example, outputs can be of low quality as there are a number of steps in a judgment process, and judgments by highly competent individuals are vulnerable to systematic traps and biases (KPMG et al., 2012). Internal auditors' JDM can be affected by their cognitive style and information processing techniques (Mills, 1996). The team performance literature suggests team dynamics and the adaptability of the team are important to the performance and outputs of the team (Ilgen et al., 2005). The external audit literature strongly focuses on JDM as part of quality. Bell et al. (2005) suggest judgments are the very essence of auditing affecting quality through the entire external audit. Also, Watkins et al. (2004) state "the application of resources is more important to audit quality than the mere availability of resources"; in other words, processes are more important than the fact that inputs have high quantities.

However process measures do not provide a user of a single task a complete indication of process or output quality (Sutton and Lampe, 1991). Processes are likely to be important in IAF users' assessments as internal auditing requires various professional judgments (Abdolmohammadi, 2012) and fieldwork quality is critical in IAF assurance activities (Lin et al., 2011).

Outputs

Outputs are what is produced as a result of the service/task and are the reason for the existence of teams, functions or services (Bonner, 2008, pp. 26-28; Ilgen, 1999; Johnson, 1995). The output view of quality appears more consistent with how one would evaluate in the real world; firms will often judge a professional's JDM based on their output, and third parties who rely on the work of others generally are most concerned whether the information provider gives the 'correct answer', and outputs are easier to measure than processes (Bonner, 2008). Bonner (2008) also suggests that while a user is often most concerned with having the correct final output, the user may wish to be confident that the professional providing the output came to their conclusion by means other than accident or chance, that is, the output is based on quality processes. This is particularly important when the provider will be used again for another output. Focusing on outputs without consideration of how the output was obtained can also impede learning as it does not permit current and exclusive feedback for improvement of processes (Bonner, 2008; Davis and Solomon, 1989). IAF users are expected to be concerned with output as the internal audit report is the key deliverable of the IAF and research has shown that to rely on IAF information, the information must be reliable, timely, relevant and effectively communicated (Burton et al., 2012; Ramamoorti, 2003).

Outcomes

Using outcomes as a criterion of assessing output is common; outcomes are the state of nature, events, or increased confidence, achieved based on outputs of the service or task (Bonner, 2008, p. 26; Sutton and Lampe, 1991). Outcome quality is largely a perceptual construct and is typically unobservable; however outcomes are a determinant in an assessment of service quality (Czepiel et al., 1985). Assessment of quality via outcomes is often driven by practical reasons (Ilgen et al., 2005). Outcome quality has also been linked to process quality; for example, Peecher and Piercey (2008) highlight external audit quality is often judged via adverse outcomes (e.g. company failure) and these adverse outcomes are generally indicative of external auditor JDM quality. External audit quality and JDM literature identify issues with measuring quality via outcomes: often there is no right answer for a task (Bonner, 2008, p. 28); there are no timely account of outcomes for accounting tasks (Davis and Solomon, 1989); quality outcomes can be achieved by poor processes, and poor outcomes can occur when there has been quality processes (Bonner, 2008, p. 27; Peecher et al., 2013);¹⁹ actual outcomes often cannot be exclusively associated to a task (Bonner, 2008, p. 28); hindsight bias is introduced where the assessor may be privy to information not available during the task or judgment (Peecher et al., 2013); and learning can be impeded as outcomes do not provide current and exclusive feedback for improvement (Bonner, 2008, pp. 27-28; Davis and Solomon, 1989). Outcomes may be used as indications of IAF quality as the core purpose of the IAF is to provide value to their users.

¹⁹ This is more prevalent in services such as audit where less ambiguous answers exist (Bonner, 2008) and is important to understand as poor processes not followed by low quality outcomes are still significant (Peecher et al., 2013).

Contextual Factors

Contextual factors are factors that may influence the quality of a service, often outside the control of the service provider. The external audit quality frameworks discussed earlier all include contextual factors such as corporate governance quality and regulation (FRC 2008; Francis, 2011; IAASB 2011; KPMG, 2010). Contextual factors can affect a decision maker and therefore need to be understood if one is to assess their decisions (Ashton, 1990; Gibbins and Newton, 1994). Outside of an audit environment, West and Anderson (1996) suggest contextual factors are important to understand as they influence each of the three dimensions of the process-orientated model (inputs, processes, outputs).

Contextual factors that have been found to affect external auditor assessment and reliance on IAF work includes audit committee quality (Cohen et al., 2007a; Krishnamoorthy and Maletta, 2008); audit committee interaction and oversight (Abbott et al., 2012; Gramling et al., 2004); inherent risk (Glover et al., 2008; Maletta, 1993; Maletta and Kida, 1993); and firm culture (Krishnamoorthy and Maletta, 2008; Lampe and Sutton, 1994; Margheim and Label, 1990). Desai et al. (2010) contend corporate governance quality must be considered by external auditors as it has a significant impact on IAF quality. Specifically, an external auditor cannot have a positive assessment of IAF quality when corporate governance quality is low or does not know the quality of corporate governance, even if the external auditor has a positive assessment about internal audit's competence, objectivity and work performance (Desai et al., 2010). The impact of these contextual factors on external auditor reliance suggests that by extension it is likely other governance stakeholders would consider and include contextual factors in their assessment of IAF quality.

2.5.1 RELATIONSHIPS OF QUALITY DIMENSIONS

The three primary dimensions of quality: inputs, processes and outputs, are argued to be linked but not causal to one another (Ilgen et al., 2005; Turnock and Handler, 1997). That is, there is an association between inputs, processes and outputs, but high quality inputs does not automatically result in high quality processes or outputs. Quality is affected at each dimension (West and Anderson, 1996) and therefore each dimension is important. For example, in a framework of external audit quality, Francis (2011) contends that each component (dimension) of his framework can influence the quality of the external audit. Users of services have also been found to consider aspects of each of these three dimensions in quality assessment (Johnson, 1995).

As the three dimensions are linked, quality is influenced at each dimension, and users' include each dimension in their assessments, an appropriate and comprehensive measure is the 'process-orientated model' (Ilgen et al., 2005; Johnson, 1995; Leitner and Warden, 2004; West and Anderson, 1996).²⁰ Process orientated models contend quality is comprised of inputs, processes and outputs. The process-orientated model is depicted in Figure 3.

Figure 3: The Process-Orientated Model of Quality

$$Quality = Inputs + Processes + Outputs$$

Alternatively, some quality models focus on outcomes of the service/task, and are referred to as an outcome model. An outcome model concentrates on the value received by a user as a result of the service (Lampe and Sutton, 1994; Sutton and Lampe, 1991). Davis and Solomon (1989) argue process-orientated models are more appropriate measures for tasks where outcomes are either unobservable or unmeasurable, or there

²⁰ The process-orientated model differs from a systems approach model as each factor is related to each other but the elements are not causal (Ilgen et al., 2005; Leitner and Warden, 2004).

are no objective benchmarks. Process-orientated models are used and considered more important over outcome models by those who can directly observe the task (Schroeder et al., 1986) and are more relevant to the provider of the service (Sutton and Lampe, 1991). However a focus solely on a process-orientated model creates boundary conditions on quality (Ilgen et al., 2005) and may also be limiting as outcomes are important to users (Bonner, 2008, p. 28). These two models do not include the contextual factors that have been shown to impact on the quality of a function. Ultimately, it is an empirical question whether IAF stakeholder quality assessments are more consistent with narrower outcome or process-orientated models or the more comprehensive theoretical framework depicted in Figure 2.

2.6 RESEARCH QUESTIONS

RQ1 is designed to determine if the different IAF stakeholders judge IAF quality differently. The premise of this question is based on research which identifies that different corporate governance stakeholders have different needs and demands of the IAF (Abbott et al., 2010), that different governance actors will often have different perceptions of quality (Cohen et al., 2004), and judge quality differently (Aguilera et al., 2008). As stated, RQ1 is:

RQ1: Do different IAF stakeholder groups judge IAF quality differently?

RQ2 also considers how IAF stakeholders judge IAF quality. The IAF quality framework posits five dimensions of IAF quality, namely: inputs, processes, outputs, outcomes, and contextual factors. This framework is based on a review of the literature conceptualising and measuring the quality of services or tasks. The review highlights that stakeholders of a service or task judge quality via any combination, or all, of these five dimensions. While a range of input, process, output, outcome and contextual factors may all be possible information cues to IAF quality, cue reduction is natural (Einhorn

and Hogarth, 1981). Psychology and accounting research highlights that people have difficulty combining multiple pieces of information to make judgments. Therefore, people simplify their judgments by focusing, and weighting, on subsets of information (Ashton, 1974; Bazerman et al., 2002; Libby, 1981; Shanteau, 1992; Tversky and Kahneman, 1974). IAF quality research has established that external auditors are driven to make judgments on quality via inputs to the function (Gramling et al., 2004). Therefore, RQ2 is designed to identify the main information cues used by the IAF stakeholders in their judgment of IAF quality and under which dimensions these fall.

RQ2: What are the main information cues used by IAF stakeholders to judge IAF quality?

As discussed in section 2.2.3, the external audit ‘three factors’ have a basis consistent with agency and source reliability theories, suggesting that these alternate theories can explain why external auditors are expected to make assessments on the ‘three factors’ when assessing quality. This thesis examines the findings of RQ1 and RQ2 based on five corporate governance theories proposed in Section 2.7, namely: agency, institutional, resource dependency, managerial hegemony and stewardship theories to determine whether judgments and the information cues used in these judgments can be explained by prescriptions of these alternate theories.

Whilst the IAF quality framework suggests quality is a construct of the five dimensions, the service and task quality literature identifies that each dimension may be comprised of a number of factors that can be influential to that dimension and overall quality. Therefore, to increase our understanding of IAF quality, RQ3 attempts to identify what factors are considered important determinants to a quality IAF.

RQ3: What input, process, output, and contextual factors are considered by IAF stakeholders as determinants to the quality of an IAF?

2.7 CORPORATE GOVERNANCE THEORETICAL PERSPECTIVES

Recent research in corporate governance finds that multiple corporate governance perspectives can help to explain and understand the complexities faced by corporate governance actors, along with these actors' motivations and behaviours (e.g. Beasley et al., 2009; Cohen et al., 2010; Hermanson et al., 2012). This thesis considers these key perspectives of governance to help understand IAF stakeholders' judgments of IAF quality and their reliance on IAF information. Judgments and perceptions of quality are likely to vary considering the organisational perspective that drives the corporate governance process (Cohen et al., 2008).

Below, five alternate theoretical corporate governance perspectives are introduced, namely: agency theory, institutional theory, resource dependency theory, managerial hegemony theory, and stewardship theory. The theories permit researchers to consider internal relationships between the corporate governance actors (Cohen et al., 2008) and are used to provide explanations in understanding the behaviour and actions of multiple corporate governance actors. Some of these perspectives are competing, however, others are complementary (Beasley et al., 2009; Cohen et al., 2002; Cohen et al., 2007b). Further, the theories are not mutually exclusive and corporate governance actors may engage in practices and behaviours consistent with a mix of the theories (Hermanson et al., 2012).

2.7.1 AGENCY THEORY

Agency theory (e.g. Fama and Jensen, 1983; Jensen and Meckling, 1976), the dominant theory in accounting and corporate governance (Beasley et al., 2009; Cohen et al., 2008; Hermanson et al., 2012; Tricker, 2012, p. 62), suggests contractual mechanisms such as corporate governance are put in place to monitor management to address the separation in ownership and control. Under the agency view, management

are viewed as self-interested actors who behave opportunistically, favouring their own interests over those they represent even if these actions are detrimental to owners (Jensen and Meckling, 1976). Thus, two mechanisms are identified to curb this behaviour: contractual mechanisms to align management goals with the principal; and information systems introduced to reduce information asymmetry between owners and management which can also restrict opportunistic behaviour through the realization by management that they cannot deceive the monitors (Cohen et al., 2008; Eisenhardt, 1989a). The agency perspective considers independence from management and expertise as the primary and central attributes of a monitor (Cohen et al., 2008; Cohen et al., 2002; Hermanson et al., 2012).

2.7.2 INSTITUTIONAL THEORY

The institutional theory perspective suggests governance structures are largely ceremonial and symbolic, driven by a desire to create legitimacy (Beasley et al., 2009). This theory posits institutions will, over time, adapt and become similar to other organisations (Cohen et al., 2008) via standards and regulations, modelling of best practices, benchmarking, and socialisation (Cohen et al., 2008; DiMaggio and Powell, 1983) whether or not these practices are best suited for the organisation (Cohen et al., 2008). The emphasis of organisations is to promote legitimacy by conforming to other organisations and is often used as a signalling mechanism of competent and effective governance (Cohen et al., 2008; Hermanson et al., 2012).

2.7.3 RESOURCE DEPENDENCY THEORY

The resource dependency perspective posits that the board is a partner of management, where management can rely on the board to acquire resources and set strategy to help achieve their objectives (Boyd, 1990; Cohen et al., 2008; Nicholson and Kiel, 2007; Nordberg, 2011, p. 40; Tricker, 2012, p. 67). Important resources are largely

undefined as this theory is drawn from both management and sociology disciplines (Nicholson and Kiel, 2007), however the corporate governance actor can provide resources including information (Nicholson and Kiel, 2007), advice, counsel, and help to foster legitimacy (Nordberg, 2011). This theory has a strategic view of value creation (Nordberg, 2011) and therefore the board plays more of a role as a collaborator with management and not the role of a monitor (Cohen et al., 2008). With the strategic focus of this perspective, high valued attributes of board members include knowledge and skills, industry expertise and reputation, and relevancy of resources (Boyd, 1990; Cohen et al., 2008; Tricker, 2012). For example, industry expertise provides the corporate governance actor, such as the audit committee member, with a greater ability to interpret, understand and assess important areas within their duties (Cohen et al., 2008).

2.7.4 MANAGERIAL HEGEMONY THEORY

The managerial hegemony perspective suggests senior management will select board members who will play a passive role in governance, will not curtail management actions, and will depend on management for organisational information, perpetuating the power of management (Cohen et al., 2008; Hermanson et al., 2012). Therefore, under this perspective, the board is largely symbolic and strongly contrasts to an agency theory perspective (Cohen et al., 2008; Cohen et al., 2002) as the board is under control of management and has virtually no monitoring role (Beasley et al., 2009).

2.7.5 STEWARDSHIP THEORY

Stewardship theory suggests the motives of the corporate governance actor are aligned with objectives of the organisation (Davis et al., 1997) and the actor has a focus on promoting value and organisational improvement (Beasley et al., 2009; Davis et al., 1997). Stewardship theory incorporates alternative behavioural principles than agency theory by suggesting behaviour does not depart from the organisations interests (Davis

et al., 1997). The behavioural principles are based on two premises: first, that the steward is naturally honest and trustworthy, motivated to do the best for the organisation and not for personal gain; and second, actors behave in an entrusting manner to not jeopardise their reputation (Nicholson and Kiel, 2007). Therefore this theory challenges the agency theory perspective (Nordberg, 2011, p. 45) and the distinction is that motivation under an agency perspective is extrinsic, versus intrinsic motivation under stewardship (Davis et al., 1997).

2.7.6 RECENT FIELD RESEARCH ON ALTERNATIVE CORPORATE GOVERNANCE THEORIES

The majority of corporate governance research has been based on an agency theory perspective (Carcello et al., 2011). However, findings in recent research suggest that alternate corporate governance theories, along with agency theory, explain behaviours and processes related to corporate governance. Cohen et al. (2007b) find external auditors consider both agency and resource dependence variables in their judgments on auditing planning. Beasley et al. (2009) find agency and institutional variables explain audit committee processes. Hermanson et al. (2012) find tension between agency, resource dependency, and institutional theories within processes of the compensation committee. Cohen et al. (2010) find that while external auditors consider the audit committee plays an important monitoring (agency) role, audit committees are often passive in resolving disagreements between external auditors and management, and management have a significant role in the appointment and termination of the external auditor. This leads to a perception that the audit committee plays a largely ceremonial role, consistent with an institutional theory perspective (Cohen et al., 2010). The significant role of management in corporate governance (Cohen et al., 2010; Cohen et al., 2002) also emphasizes that a focus on agency theory may be limiting as the agency theory perspective largely prescribes the monitoring of management.

Collectively, these findings emphasize the need for research to examine corporate governance beyond the agency theory view (Hermanson et al., 2012). Agency theory does not take into account broader contextual issues such as organisational and environmental complexities (Aguilera et al., 2008; Davis et al., 1997). Therefore, research limited to an agency perspective may lose the richness that alternative governance perspectives can provide (Cohen et al., 2008).

Evidence collected as part of this research will be analysed within the rubric of corporate governance theories discussed, namely: agency, institutional, resource dependency, managerial hegemony, and stewardship theories. Considering the above findings from recent corporate governance research where multiple theories help to explain corporate governance behaviours and processes, this thesis does not make expectations as to which theories will drive processes and judgments related to IAF quality.

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The purpose of this chapter is to discuss the qualitative methodology chosen and employed to investigate the research questions developed in Chapter 2. The predominant data collection method used was semi-structured interviews. Semi-structured interviews were chosen due to the nature of the research questions and to gain deep insights into IAF quality from corporate governance stakeholders who make assessments on IAF quality. Interviews were conducted with 36 individuals including audit committee members and chairs, senior management and internal auditors to capture the information cues used in their judgments of IAF quality and the factors they consider determinants of IAF quality. A focus group was conducted prior to the interviews and is discussed briefly in the next section. The remainder of the chapter is dedicated to the interview method including the choice of semi-structured interviews,

the sample, details of the interview process, actions to address validity and reliability concerns, and the steps of data analysis.

3.1 FOCUS GROUP

A focus group was conducted in the developmental stage of the research prior to the field interviews. Five internal audit practitioners participated in the focus group and were asked broad questions related to who in the organisation would assess IAF quality and what factors may influence their assessment of IAF quality. Insights obtained from the focus group discussion were drawn on to inform and develop the theoretical framework developed in Chapter 2 (Wouters et al., 2005), and to clarify issues and themes to investigate in the field interviews (Silverman, 2010, p. 197). Details on the choice of employing a focus group method, the specifics of this focus group, and the results of this focus group are provided in Appendix D.

3.2 FIELD INTERVIEWS

The research questions and current knowledge of the phenomenon under study drive the choice and appropriateness of a research method (Birnberg et al., 1990). The research questions in this study are designed to gather contextual understanding of how business professionals judge IAF quality, the information cues used in their judgments, and determinants of IAF quality. Bonner (2008, p. 45) suggests a way to understand how professionals assess others' judgements and decisions and the dimensions which are important in this assessment, is to ask the professionals via interviews.

Interviews are a method to study a phenomena via direct contact with people involved in the organisation (Merchant and Van der Stede, 2006). Benefits of interviews are that they allow a researcher to gain insights and understanding into issues and complexities of a phenomenon which are difficult to obtain via archival methods

(Beasley et al., 2009; Gendron, 2009; Lillis, 1999; Radcliffe, 2010); may not yet be evident in theory (Lillis, 2006) such as key omitted variables (Lillis, 2008); may be complex and/or dynamic with many variables (Cooper and Morgan, 2008); or are potentially not well defined or structured (Birnberg et al., 1990). Interviews can also provide a deeper richness, broader understanding, and descriptions of the phenomenon over other research methods (Birnberg et al., 1990; Merchant and Van der Stede, 2006; Miles and Huberman, 1994, p. 10; Patton, 2002, p. 14; Silverman, 1993, p. 15); they are flexible (Miles and Huberman, 1994, p. 10; Silverman, 1993, p. 171); and can elicit highly detailed information such as insights on participants experiences (Cohen et al., 2002) and actual decisions and workings of the professional (Cohen et al., 2008; Gendron et al., 2004).

Negative factors of conducting interviews include practicality issues such as the associated costs with respect to participant availability, data collection and coding (Cohen et al., 2002) which limits potential sample size (Carcello et al., 2011; Cohen et al., 2002; Lillis, 1999; Patton, 2002, p. 14) and as a consequence the generalizability of results (Patton, 2002, p. 14). Despite this limitation, multiple cases were chosen as the use of multiple cases helps to identify those conditions in which a finding will occur (Miles and Huberman, 1994, p. 173) and to understand variation and isolate patterns (Lillis, 1999; Patton, 2002, p. 244).

3.2.1 SEMI-STRUCTURED INTERVIEWS

Data was collected via semi-structured interviews to obtain insights and experiences on IAF quality. Semi-structured interviews were chosen over other interview types as they are often used in exploratory research phases (Bedard et al., 2012). Encompassing the advantages and disadvantages outlined above for interviews, semi-structured interviews have an extra advantage in that they provide the researcher

opportunities to explore important paths which emerge during the interview due to their inherent flexibility (Gendron et al., 2004; Miles and Huberman, 1994, p. 10). Lillis (1999) contends that semi-structured interviews are subject to interviewer bias which can be present in both the interview itself and analysis which can significantly affect credibility of the study. To limit interviewer bias Lillis highlights introducing research design features such as the use of an interview guide and an analysis protocol. Both features were employed in this study and are discussed in this chapter. The method also drew heavily on the approaches used by authors of a number of accounting, auditing, and corporate governance field research studies published in leading accounting journals to minimise concerns related to validity and reliability of field studies, and suggestions by Gendron (2009) and Radcliffe (2010) to combine rigour and openness in accounting field study research.

3.3 SAMPLE

3.3.1 PARTICIPANTS

Interviews were conducted with 36 individuals, including 18 ‘users’ of internal audit: nine audit committee members and nine senior managers (CFO’s and financial controllers); and 18 ‘providers’ of internal audit, including ten heads of in-house internal audit departments,²¹ and seven partners, and one director, of internal audit divisions from large accounting firms.²²

The following abbreviations are used to identify participants: AC = audit committee member/chair; SM = senior manager; IA Head = heads of in-house internal

²¹ Within the in-house internal audit group, participants hold multiple titles although positions were of equal status. Examples of titles included ‘Chief Audit Executive’, ‘Head Internal Audit’, and ‘Internal Audit Manager’.

²² In Australia, some accounting firms use the term director to indicate the level between manager and partner. This position does involve in-charge-responsibilities for clients. For convenience, all accounting firm participants are referred to as partners (IA Partners) in this thesis.

audit departments; IA Partner = partners of internal audit divisions from large accounting firms.

Participants were from large Australian publicly listed firms (listed on the Australian Securities Exchange (ASX));²³ large accounting firms (including each of the Big 4 and one second tier firm) and one unlisted financial organisation. Table 3 – Table 5 provide demographic details of participants and their associated firms. These tables indicate the sample is representative of a broad range of firm industry and size, and participant experience.

The number of interviews (36) was felt to be sufficient as the researcher perceived theoretical saturation was reached at this point (Eisenhardt, 1989b). That is, minimal new insights were emerging with each of the later new interviews. While Strauss and Corbin (1998, p. 136) contend that in reality, a researcher could always find more information, they and Eisenhardt (1989b) suggest the collection of this information is counterproductive in terms of pragmatic considerations such as time and money when it often adds little more information to the phenomenon under study.

²³ 44% of the sample represented publicly listed firms ranked in the top 30 ASX companies by market capitalisation.

Table 3: Participant Demographics

Audit Committee (n = 9)			<i>n</i>	Percent	Mean	Min.	Max.
Position:	Chair		5	56			
	Member		4	44			
Qualifications:	Education level:	Bachelor	4	44			
		Master	2	22			
		Honours	1	11			
		Ph.D.	2	22			
	CA/CPA qualification		9	100			
Experience:	Prior experience as an internal auditor		0	0			
	Former Big-4 external audit partner		5	56			
	Number of audit committees currently serving ^a				3.7	1	8
	Number of audit committees previously served ^{a b}				2.2	0	10+
Senior Management (n = 9)			<i>n</i>	Percent	Mean	Min.	Max.
Position:	CFO		5	56			
	Financial Controller		3	33			
	General Manager		1	11			
Qualifications:	Education level:	Bachelor	4	44			
		Master	2	22			
		MBA	3	33			
	CA/CPA qualification		8	89			
Experience:	Prior experience as an internal auditor		2	22			
	Professional experience in finance/ accounting (years)				20.9	8	41
Internal Audit Head (n = 10)			<i>n</i>	Percent	Mean	Min.	Max.
Position:	Head of Internal Audit		10	100			
Qualifications:	Education level:	Bachelor	7	70			
		Master	2	20			
		Honours	1	10			
	CA/CPA qualification		10	100			
Experience:	Internal audit experience (years)				16.2	2	29
Internal Audit Partner (n = 8)			<i>n</i>	Percent	Mean	Min.	Max.
Position:	Partner		7	88			
	Director		1	13			
Qualifications:	Education level:	Bachelor	8	100			
	CA/CPA qualification		8	100			
Experience:	Internal audit experience (years)				15.8	11	25

Notes:

^a Disclosed audit committee service including public and private organisations.

^b One participant reported their past service as '10+' audit committees; average was calculated on 10.

Table 4: Participant Industry

(n = 36)	Audit Committee		Senior Management		Internal Audit Head		Internal Audit Partner		Total	
	n	%	n	%	n	%	n	%	n	%
Financials	3	33	4	44	3	30	-	-	10	27.8
Industrials	4	44	2	22	0	0	-	-	6	16.7
Consumer Discretionary	1	11	1	11	2	20	-	-	4	11.1
Utilities	1	11	0	0	1	10	-	-	2	5.6
Consumer Staples	0	0	2	22	0	0	-	-	2	5.6
Materials	0	0	0	0	2	20	-	-	2	5.6
Energy	0	0	0	0	1	10	-	-	1	2.8
Health Care	0	0	0	0	1	10	-	-	1	2.8
Big 4	-	-	-	-	-	-	6	75	6	16.7
Non-Big 4	-	-	-	-	-	-	2	25	2	5.6
Total	9	100	9	100	10	100	8	100	36	100.00

Table 5: Participant Firm Size

(n = 27)^a

Market Capitalisation	Total Assets			Revenue							
	AC	SM	IA Head	AC	SM	IA Head					
\$0-999m	3	2	1	\$0-999m	1	2	0	\$0-999m	3	3	1
\$1b-9b	4	2	5	\$1b-9b	5	3	6	\$1b-9b	4	2	5
\$10b-49b	1	2	1	\$10b-49b	1	0	0	\$10b-49b	1	4	2
\$50b+	0	3	3	\$50b+	1	4	4	\$50b+	0	0	2
Average	4.4b	29.5b	36.5b	Average	7.9b	247.3b	110.0b	Average	2.9b	17.1b	21.1b

^a IA Partners not included in participant firm size. Data was also not available for the participant representing a non-listed financial organisation.

3.3.2 PARTICIPANT SELECTION

The groups of participants were chosen in line with the internal governance stakeholders in Cohen et al.'s (2004) model of corporate governance (Figure 1) which includes audit committees as the representatives of the board of directors, senior management and internal auditors. All participants were required to serve (be employed or contracted to) an Australian publicly listed firm that had both an audit committee and utilised an internal audit function (either an in-house department, co-sourced arrangement or fully outsourced).²⁴ Internal audit partners were required to conduct audits as the out-/co-sourced provider for publicly listed firms.

Audit committee members and senior managers represent the 'users' of internal audit. CFOs and financial controllers were chosen as the senior management participants as the Auditor Director Roundtable (2007) found internal audit's primary reporting relationship was to the audit committee, whilst their secondary reporting relationship was to the CFO and included financial controllers. These two users are also part of the key triangle of communication with the IAF (Abdolmohammadi et al., 2013)

Obtaining the perspective of the internal auditor (the 'provider') is important as internal auditors play a role in the quality of internal audit and gaining their insights allows comparison between the service provider and the client (the 'users') (Gramling et al., 2004). Engaging the provider is also important to develop measures to monitor and improve quality (Havelka et al., 1998). Further, individual's providing a service can specify insights about factors impacting the quality of their performance (Sutton, 1993) and are in a better position to know their performance quality compared to a user

²⁴ Focus on larger corporations was due to the relationship between firm size and the presence of an audit committee and an internal audit function. Only the top 300 companies of the ASX (as listed on the S&P/ASX 300) are required to have an audit committee (ASX 2010). Further, there is a strong correlation between firm size and existence of an internal audit function (Arena and Azzone, 2009; Goodwin-Stewart and Kent, 2006). However, smaller firms that had both an audit committee and internal audit were included to not constrain the sample.

(Fischer, 1996). Both in-house internal audit and outsourced internal audit providers were chosen as participant groups. Increasingly, firms are beginning to outsource or co-source their internal audit activity and it is now very common within organisations (Brandon, 2010; Carey et al., 2006; Glover et al., 2008). Further, differences in the interpretations of IAF quality may occur between the two providers. Internal audit literature suggests in-house departments and outsourced providers have different motivations and incentives, and there are differences in the nature of relationships with clients (Desai et al., 2011; Glover et al., 2008).

External auditors were not included in the sample for two reasons. First, the abundance of studies relating to external auditor evaluation of internal audit (see Gramling et al. (2004) and Bame-Aldred et al. (2013) for reviews of this literature). Secondly, external auditors are required to adhere to professional standards that prescribe how the external auditor shall assess the quality of internal audit. As a result of these standards and an external auditor's obligation to adhere to these standards, it is probable that an external auditor would judge and describe quality and its attributes in conformance to these standards.

The majority of participants (23) were acquired through personal acquaintances and university-related contacts. Ten participants were identified through "snowball procedures" (Tremblay and Gendron, 2011). Two heads of in-house IAFs and one internal audit partner were attained through the assistance of the Institute of Internal Auditors (IIA) Australia.²⁵ Non-response to requests solicited by the IIA and through the snowball procedure is unknown. Of the potential participants personally approached,

²⁵ Further individuals identified by IIA Australia indicated willingness to participate in this study, however the number of participants used from this source was limited by the researcher due to potential participant/respondent bias of close affiliation with the internal audit professions leading body (Beasley et al., 2009).

only two declined to be interviewed as they were overseas for extended periods of time during data collection; four others did not respond to the email request. It is unclear if there would be differences in insights gained from non-respondents or those unable to participate. However, given the high acceptance rate, low sampling bias should be present as the participants are likely to be representative of the population (Birnberg et al., 1990).

3.3.3 SAMPLE NUANCES

Due to the nature and complexity of procuring a large number of participants for qualitative studies, many studies have nuances in their sample. For example, Beasley et al. (2009) and Tremblay and Gendron (2011) used at least one participant recently retired from service in their samples of audit committees. Beasley et al. (2009) also had one mutual fund included in their sample of publicly listed companies, while Cohen et al. (2002) included one non Big 5 firm to their sample of 36 Big 5 audit firms. Trompeter and Wright (2010) had to deal with an interviewee changing audit positions after arranging their sample and Gendron (2002) added audit managers from large accounting firms to his sample of audit partners.

Similarly, the sample for this research contained some nuances. First one senior manager had recently retired; this participant had over 40 years' experience within business roles including over 10 years as CFO. This participant also had a long association with internal audit including a period of managing the IAF. Second, one firm had recently been delisted from the ASX after being (majority) acquired by an overseas firm. Despite the ownership change, the business has continued operating in the same way and executive, audit committee, and internal audit positions were unchanged. Third, one participant from the senior management group did not hold an accounting/finance position. However, this person was trained as an accountant and in

their position as General Manager spent significant time with internal audit due to the significant risks around the operations in their industry. Fourth, one audit committee participant represented a large unlisted financial organisation and therefore was from a different ownership structure to the rest of the sample; however the size, complexity and economic influence of this organisation was considered of equal significance. This participant also had experience equal to or greater than many participants with large listed and unlisted firms including experience with their IAFs, and currently also holds director positions on large private and not-for-profit organisations.

Despite these nuances, it is believed the insights from these participants added value to the study and should remain in the sample. These participants had the experience required to discuss IAF quality within large organisations. Further, the nature of the research questions were designed to examine the processes used by governance stakeholders to judge IAF quality, not to determine IAF quality within specific companies.

3.4 INTERVIEW PROCEDURE AND PROTOCOL

3.4.1 CONDUCT OF INTERVIEW

Interviews were conducted between April and August 2012 in major Australian cities. The length of the interviews ranged from 44 to 81 minutes, with an approximate average of 54 minutes. This length of interview is consistent with many similar studies in audit and corporate governance (e.g. Cohen et al., 2010; Cohen et al., 2002; Gendron and Bédard, 2006; Gendron et al., 2004; Tremblay and Gendron, 2011; Trompeter and Wright, 2010). All interviews were conducted face-to-face with one exception, which was conducted via telephone due to logistical limitations (flight time in excess of ten

hours).²⁶ Other accounting research which has combined face-to-face and telephone interviews to collect data include Beasley et al. (2009), Cohen et al. (2013b), Gendron and Bédard (2006) and Graham et al. (2005).²⁷

Each of the interviews were conducted by the one researcher. This enabled consistency amongst interviews in the asking of questions and probing of relevant themes. The use of one researcher has been argued to lead to potential interviewer bias, due to a researcher's predispositions and perceptions (Patton, 2002, p. 567). However, Patton counters this argument indicating the use of different fieldworkers collecting data can distort findings (an instrumentation effect). The researcher believed that the consistency provided by the use of the single investigator helped maintained consistency. To limit potential bias, considerable effort was placed on the development of the interview guide.

3.4.2 INTERVIEW GUIDE (INSTRUMENT)

A standardised interview guide was used for all interviews to provide a consistent approach and coverage of themes in each interview (Beasley et al., 2009; Patton, 2002, p. 343). An interview guide can help keep the interview situational and conversational (Patton, 2002, p. 349), ensure completeness in covering the specified topics or themes (Lillis, 1999) and can minimise bias caused by interviewer intrusion by using pre-specified questions and probes which are non-directive (Lillis, 1999). The interview guide (provided in Appendix E) is structured around key questions on participant's experiences with the IAF, with some questions having potential probes that could be used to elicit deeper responses. Similar to Gendron et al. (2004), the interview guide

²⁶ The nature of this participant's response did not appear to be affected by conducting the interview over the phone and was similar to other interviewees.

²⁷ For example, Graham et al. (2005) conducted two of their 37 interviews via telephone; Cohen et al. (2013b) conducted one of 22 interviews via telephone.

was customised for each group of interviewees.²⁸ Further, each interviewee was not asked all questions.²⁹

In line with the approaches of Beasley et al. (2009), Cohen et al. (2010) and Hirst and Koonce (1996) the interview guide was reviewed by five academics in the fields of audit or corporate governance and one academic from psychology, for relevance, clarity and completeness (Cohen et al., 2010). Three pilot tests were also conducted (which were not included in the subject pool). Participants recruited for the pilot tests included an internal audit manager, a CFO, and an audit committee member who previously held positions as an internal auditor and company secretary. As a result of the feedback on the interview guide and pilot tests, modifications were made to improve the research instrument and approach (Gendron, 2002).³⁰ The research instrument evolved and was revised as necessary over the course of the interviews when new themes arose or when a theme was discovered revealing a need for deeper questioning and insights (Anderson and Lillis, 2011; Cohen et al., 2002; Gendron and Bédard, 2006; Hirst and Koonce, 1996).

Each interview began with measures to reduce participants' reluctance to freely provide their insights by drawing heavily on the approaches taken by Cohen et al. (2002), Gendron (2001, 2002), Gendron and Bédard (2006); and Hirst and Koonce (1996). First, discussed with participants was the broad objective of the research, the

²⁸ Only minor changes were made. The emphasis and themes of the questions were not changed; simply, questions were restructured for participants various positions such as 'providers' or 'users'.

²⁹ Following Hirst and Koonce (1996), as the purpose of this study was to increase our understanding of IAF quality in practice, the benefit gained from exploring interviewee responses outweighed an attempt to limit the interviewee to the pre-established questions due to time constraints. Further, Radcliffe (2010) suggests using less structure in semi-structured interviews to pursue important and interesting insights, so as to understand the meaning of these insights.

³⁰ For example, unclear and leading questions were redeveloped. Further, pilot-test participants suggested one question to be removed as it was repetitious; their answers to this question confirmed this suggestion, as all three participants repeated and/or referred back to their previous answers and did not provide any further insights.

interest in their experiences and the planned use of the data collected. Second, participants were assured of the anonymity of their answers for themselves and their firm, and that their responses would not be shared with anyone else from their organisation. Third, the researcher highlighted the benefits of recording the interview and asked for participant's permission to allow the interview to be recorded. Fourth, participants were informed they would be given the opportunity to verify the interview transcript to remain comfortable with what they had said after the fact. These approaches help to build trustworthiness of the interviewee (Tremblay and Gendron, 2011) and limit response bias (Gendron, 2002). This process was followed by initial questions asking factual background information on participants' experience, demographics and their organisation to help set the scene for the remainder of the interview and to have participants ease into the recorded interview, before proceeding to questions based on the research questions (Hirst and Koonce, 1996).

Neither a definition of IAF quality or attributes of IAF quality were discussed by the researcher due to the exploratory nature of the research and the potentially serious effects of leading respondents to answers (Schroeder et al., 1986), or responses being artefacts of the interview process (Malina and Selto, 2001). Also, when asking probing questions the researcher refrained from introducing or highlighting potential quality determinants therefore allowing respondents to provide responses from their own experiences (Anderson and Lillis, 2011; Carcello et al., 1992; Gendron, 2002; Schroeder et al., 1986).

Following Hirst and Koonce (1996), Beasley, et al. (2009) and Cohen et al. (2010; 2002) when interviewee responses indicated an important path, this path was pursued before returning to the interview guide. Probing questions were used when the interviewer wished participants to elaborate on their response, their response was

unclear or unrelated to the theme under question (Gendron, 2001; Patton, 2002, p. 372). If a participant's response answered a forthcoming question, the question was not asked or rephrased in a way to gain deeper insight (McCracken et al., 2008).

3.4.3 INTERVIEW QUESTIONS

Interview questions were derived from the literature review in Chapter 2 including literature on IAF quality and the multiple disciplines measuring the quality of services and tasks. Other complementary sources included the extant internal audit literature, professional literature (including relevant internal and external audit standards, professional body and institution publications) and the focus group conducted in the developmental stage of this research.

The most critical question discussed with interviewees revolved around how they made judgments about the quality of the IAF and determinants of both high and low quality internal audits. The broad and critical questions of this study were asked early in the interview, responding to suggestions by Hermanson et al. (2012) for researchers to ask broad questions early to give participants the opportunity to delve deeply into the issues under study. Interview questions are outlined in the interview guide provided in Appendix E. Questions were designed to focus on participant experiences and not their opinions (Cohen et al., 2010).

Anchoring Questions

Participants were not asked directly about how they make judgments of IAF quality or the determinants of a quality IAF, rather, questions were indirect and based on examples to limit selective perceptions and preconceived notions of the interviewee (Plous, 1993, p. 15). Perceptions are influenced by cognitive factors, that is, prior beliefs and expectations including what a person expects and wants to see (Plous, 1993, p. 18). Further, interviewees can become introspective in their beliefs when asked

questions (Birnberg et al., 1990) and provide answers they perceive the researcher wants, known as ‘helpfulness’. To overcome this, and to be able to draw valid contextual information from participants, it has been suggested that an interviewer must ask respondents about experiences with a certain phenomenon and not simply opinions or insights (Gibbins and Qu, 2005). Therefore, the main questions of the interview guide were anchored around participants’ experiences.³¹ This protocol of anchoring participants’ responses on their experiences is often used in qualitative accounting studies employing data collection methods, such as interviews and experimental questionnaires (for example Cohen et al., 2010; Gibbins et al., 2005; Gibbins et al., 2007; Gibbins and Qu, 2005; Gibbins and Trotman, 2002; McCracken et al., 2008; Nelson et al., 2002; Rennie et al., 2010).

The first question asked participants to recall and discuss either a high or low quality internal audit engagement they had been associated with (that is, prepared or overseen by the internal auditor; presented to the senior manager or audit committee; or for senior management, was in an area of their oversight). Participants were then asked about the opposite (that is, when a participant discussed a high quality engagement, they were then asked about a lower quality engagement). The second question asked participants to compare two different IAF’s they have been associated with to justify their assessment of quality through comparison (Gendron and Bédard, 2006).

Asking for both high and low quality examples of IAF quality helped control for the bias of overstating (understating) of quality and quality determinants, as well as

³¹ Specific experiences/examples were of the participant’s choice. Prior to the commencement of the interview questions, participants were informed that they would be asked for examples and that these examples could be experiences from their current organisation which they represent or a previous organisation. Examples from previous organisation were acceptable as the company itself was not influential to the research questions or results, and the objective was not to ascertain the quality of the internal audit for a specific company. However, participants were requested to choose examples, where possible, where they had the same or similar role. The reason for this was many audit committee members were former external audit partners or CFO’s.

controlling for the directional effect of attributes.³² Further, to limit effects of recall bias, when not indicated by the interviewee, participants were asked how often they experienced these characteristics. If participants seemed to be ‘listing’ high or low quality characteristics, they were encouraged to provide an example to substantiate these ideas (Gendron et al., 2004). Based on the examples provided by participants, including cases both favourable and unfavourable towards internal audit quality, and the extent of detail provided, responses were perceived as candid (Hirst and Koonce, 1996).

Interviews were completed by asking participants if there was anything they would like to add or which they felt was not covered in the interview. This is often referred to as a closing or clearing question (Eriksson and Kovalainen, 2008, p. 85; Patton, 2002, p. 379) and used by (Cohen et al., 2010; Hirst and Koonce, 1996). In many cases this lead to interesting data, yet was often an opinion related concept of internal audit in general.³³

3.5 VALIDITY AND RELIABILITY ISSUES

The above sections addressed the choice of method used, the population and sample, and the procedure and instrument used to collect data. Within each of these sections, critical validity and reliability concerns are addressed. The sections below discuss further validity and reliability issues of qualitative research and the choices made by the researcher to address these issues.

3.5.1 RECORDING

Recent field interview research published in leading accounting journals is divided on the option of whether or not to record interviews. For example, interviews

³² Schroeder et al. (1986) noted a limitation of their study was participants were asked to “not distinguish between positive and negative audit quality effects”; as a result, there were some factors that were ambiguous as to which directional effect they had (they provided the example of audit team rotation).

³³ These answers were included in the data when both coders (see Section 3.6.1) agreed they were influential or relevant to the themes under study.

are recorded by Cohen et al. (2010; 2002), Gendron and Bédard (2006), Gendron et al. (2004), McCracken et al. (2008), (2011) and Trompeter and Wright (2010). However, interviews are not recorded by Beasley et al. (2009), Gendron (2001, 2002) and Hermanson et al. (2012). The decision to record is based on whether researchers perceive the benefits of recording to outweigh the negatives, or vice versa.

Benefits of recording include greater accuracy and completeness (Cohen et al., 2010; Cohen et al., 2002; Patton, 2002, p. 381; Yin, 2009, p. 109) which can enhance the validity of the research (Minichiello et al., 2008, p. 117). Recording provides the researcher the opportunity to build greater rapport with the interviewee by being more attentive, rather than focusing on note taking (Minichiello et al., 2008; Patton, 2002). Recording also allows the researcher to return to the original recording for any clarification (Silverman, 2010, p. 210) and as such can reduce the chance of misinterpretation by keeping data in context (Patton, 2002). Recording can also have negative effects including lowering the comfort of the interviewee, thus inhibiting conversation and restricting the freeness in which interviewees provide information and contribute their insights (Gendron, 2001, 2002). For example, Beasley et al. (2009) chose not to record because of the ‘tense and fearful’ nature of the corporate governance environment at the time of their interviews which they perceived may limit the freeness of responses by participants if they were to be recorded. Finally, recording devices are also prone to malfunctions (Patton, 2002).

Interviews for this study were recorded due to the exploratory nature of the research questions (that is, the questions were not invasive), only a single researcher being present at interviews, and the researcher’s perception that the above positives of

recording outweighed any negatives.³⁴ After explaining the purpose and benefits of recording, a request was made to each participant to allow the interview to be recorded. With permission, all but two interviews were recorded and signed consent was acquired.³⁵ For the two interviews not recorded, the ‘memory-transcript’ method was used; that is, key notes were taken during the interview and detailed notes were made immediately following the interview (Gendron, 2001, 2002). Each participant was offered to be provided a copy of the transcript to verify accuracy and ensure, after the fact, they were comfortable with what they had said in the interview and had the opportunity to either add to or delete from the transcript where they felt necessary to achieve comfort with their response (Gendron and Bédard, 2006; McCracken et al., 2008; Tremblay and Gendron, 2011).³⁶

Recording provided one further benefit to the research process. Recorded interviews were transcribed verbatim by the researcher and produced over 350 pages of data. Patton (2002, p. 441) suggests transcription conducted by the researcher provides the opportunity for the researcher to become immersed in the data which benefits analysis through greater familiarity and deeper knowledge of the data and the generation of new ideas.

³⁴ Responses are not believed to be any less candid as a result of recording. For instance, a number of interviewees mentioned that certain points they raised were not quotable; generally these were mostly personal opinions or reflections of surrounding events. As per ethical obligations, these requests were upheld and those passages of data were not quoted.

³⁵ One participant denied the request as they felt it was inappropriate in the current climate of their organisation; the other participant was unable to be recorded due to logistical reasons. Similarly Cohen et al. (2013a) were unable to record two of 32 interviews due to non-consent.

³⁶ Eleven of the 36 participants accepted this offer. Transcripts were sent to the participant within one week of the interview. Participants were asked to indicate any changes to the transcript they wished to make or if they were content with the transcript as it stood. A reminder was sent after 2 and 3 weeks. Participants were informed that after 4 weeks no response would be determined by the researcher to indicate that the participant was happy for the transcript to be analysed as is. Only minor modifications were made to the transcripts by three interviewees. Four participants did not make any changes, whilst three participants did not reply. One participant requested to be contacted if any of their quotes were to be used to verify they were used in context. In accordance with ethical requirements and commitments made to participants, modified transcripts were analysed where provided.

3.5.2 RESEARCHER NOTES

In addition to recording the interviews, brief notes of key ideas and themes raised were taken during each interview. These notes were expanded into more detail directly after each interview. Patton (2002, p. 383) suggests taking strategic and focused notes during an interview (even when recording) can help the interviewer develop questions to ask, or aid as a reminder of an issue raised, for later in the interview; stimulate ideas to pursue in following interviews; facilitate analysis of the data later on; and act as a back-up to the recording. Observational notes were also made after each interview as suggested by (Miles and Huberman, 1994, pp. 50-51, 69-71). These notes detailed the interviewer's reflections on the interview including thoughts on interviewee candidness and rapport, their responses and significant ideas to pursue and highlighted salient themes raised. These notes provide a platform to aid interpretation of transcripts during analysis (Irvine and Gaffikin, 2006; Patton, 2002, p. 384).

3.5.3 ORGANISATION DOCUMENTS

Prior to each interview, where available, documents produced by the interviewee's organisation were reviewed. These documents included annual reports, corporate governance statements, corporate governance policies, audit committee and internal audit charters, risk management policies, the organisation's website, and any relevant recent press. Review of these documents provides two main benefits: first, a researcher has greater insight into the organisation and is able to pursue salient areas that arise in the interview with potential background knowledge. This included the role and scope of the IAF, the IAF's stature within the organisation, and governance and risk attributes of the firm. Second, an understanding of the organisation's context and processes allows the researcher to contextualise and understand responses gathered during fieldwork which is essential for analysis (Patton, 2002, p. 59). Irvine & Gaffikin

(2006) suggest that to ignore documents associated with the company regarding the phenomenon would be distorting the context in which the phenomenon occurs. Many auditing field studies incorporate this process including McCracken et al. (2008), Gendron and Bédard (2006), Gendron et al. (2004) and Gendron (2002),

3.5.4 CANDIDNESS

All interviewees were perceived by the researcher to be candid in their responses. For example, interviewees often referred directly about, and provided names of, companies and specific people during the interview. These comments were often around sensitive issues. Many participants used colourful language and emotive terminology.³⁷ As detailed previously, a number of participants asked for certain passages of discussion not to be quoted directly.

3.6 DATA ANALYSIS

There is no fixed formulae for analysis of qualitative data (Yin, 2009, p. 127). One of the challenges of qualitative methodologies exists in the amount of data, and the endeavour in processes such as: reducing the volume, identification of significant pieces of information and patterns, interpreting and making sense of the information and communicating the findings (Patton, 2002, p. 432). An oft used schema to aid qualitative analysis is that developed by Miles & Huberman (1994, pp. 10-11) who suggest analysis of data consists of three concurrent activities: (1) data reduction; (2) data display; and (3) conclusion drawing and verification. Data reduction is a process which occurs continuously through the entire project. It includes anticipatory data reduction in the form of research questions and methods; and through fieldwork and analysis – in such aspects as coding, identifying themes and building clusters. It is a

³⁷ This is removed from any quotes reported in this thesis where inclusion is not essential.

process that simplifies and sharpens data to aid the two following steps. Data display is a process of displaying information in a way to aid the researcher to reach conclusions and actions. Text can be cumbersome, without a display the researcher may reach unfounded conclusions by dismissing text. Conclusion drawing and verification is a two part process; the first involves making sense of what the information (data) is telling us; the second is assessing these meanings for their validity.

Data collected in this study was analysed using this qualitative analysis protocol proposed by Miles and Huberman (1994) and supplemented with methods proposed by Eisenhardt (1989b) and Yin (2009). For example, Yin (2009) identifies three strategies pertinent to this research project, including reliance on theoretical propositions, pattern matching and between-case synthesis. Lillis (1999) suggests an analytical protocol can increase credibility in the results of a qualitative analysis as it: (1) provides an audit trail of analysis procedures, (2) ensures all data is considered, and (3) provides a framework for testing of initial hypotheses and emerging propositions. A further benefit of following an analysis protocol is that it puts the evidence in some preliminary order (Yin, 2009).

3.6.1 CODING

Codes are the units of analysis applied to the data (Miles and Huberman, 1994, p. 56). Coding schemes help to categorise and summarize the interview data (Beasley et al., 2009), with the objective of matching the observations present in the data to a set of constructs or theory (Miles and Huberman, 1994, p. 58). As data collection began with a theoretical framework, a preliminary coding scheme was developed reflecting this framework and was consistent with questions in the interview guide. Initial coding was conducted during the fieldwork period. Coding during fieldwork is an early phase of analysis and provides the benefit of driving future data collection by highlighting any

bias or areas not being researched in-depth and emerging patterns to follow (Miles and Huberman, 1994, p. 65; Patton, 2002, p. 437); and, overall, increasing data sensitivity (Gendron and Bédard, 2006; Patton, 2002, p. 437; Tremblay and Gendron, 2011).

The initial coding process was also used as a form of open coding (Patton, 2002, p. 433) where codes were identified through the discovery of patterns, themes and categories in the data and was combined with the coding categories identified pre-fieldwork. Codes were refined into sub categories to enable greater precision and explanation of the initial constructs (Strauss and Corbin, 1998, p. 124). When the coding scheme was perceived to cover both anticipated and unanticipated codes, the codebook was developed (provided in Appendix F). The codebook provided definitions for each code and was followed by each coder. All transcripts were reviewed and coded in line with the code book to identify key themes in the data (Gendron, 2002; McCracken et al., 2008).

Coding is the most subjective stage in the analysis of qualitative research (Malina and Selto, 2001). Therefore, the establishment of coding reliability is critical to the validity and reliability of the research (Abernethy et al., 2005; Lillis, 1999). Reliability of coding and ultimately the findings is more reliable when two researchers code the data independently (Miles and Huberman, 1994, p. 64). Each transcript was coded by the researcher and one research assistant who was independent of the research and the research questions.³⁸ The following steps were taken to increase coding reliability. The first two transcripts were coded independently by each coder along the definitions provided in the code book. On completion, the coders met to compare coding and discuss the suitability of the codes and the applied definitions. The coders agreed on a

³⁸ Having a coder unaware of the research questions may increase random coding error (that is, decrease coding reliability); however, a coder's awareness of the underlying premise of the research can produce coding bias (Gibbins and Newton, 1994).

refined set of codes. Discussion of initial coding difficulties results in sharper definitions applied to codes (Abernethy et al., 2005). This process was repeated after coding another three transcripts. The remaining transcripts were coded and transcripts coded during training were also recoded in accordance with the updated coding book.

Coding reliability is established by comparing the ratio of agreements and disagreements between coders across all transcripts. Reliability is sustained by a high inter-coder agreement as interpretation is less likely to be researcher biased (Gendron, 2009). Coding reliability is based on the following formula (Miles and Huberman, 1994, p. 64):³⁹

Figure 4: Coding Reliability Formula

$$\text{Coding Reliability} = \frac{\text{number of agreements}}{\text{total number of agreements} + \text{disagreements}}$$

Agreements occur when coders use the same code for the approximate same portion of text. A disagreement occurs when coders use a different code or do not apply a code to a section of text. As coders were allowed to code at any level of detail (sentences, paragraphs, etc.) and were allowed to provide dual codes to text,⁴⁰ minor differences in the boundaries of codes were not considered disagreements (Abernethy et al., 2005; Malina and Selto, 2001).

Based on the above formula, the two coders achieved reliability of 86%, indicating a high level of inter-coder reliability (Cohen et al., 2010; Cohen et al., 2013b; Miles and Huberman, 1994).⁴¹ The average is also roughly equivalent to accounting

³⁹ Many studies do not disclose how they formulated coding reliability; two studies which disclose how they calculated coding reliability are Abernethy et al. (2005) and Malina and Selto (2001), who both use this formula.

⁴⁰ Passages of data were able to be coded into multiple codes so as not to break important linkages in the data, which yields more reliable coding (Anderson et al., 2012a).

⁴¹ Intra-coder reliability, the reliability of a coder when coding the same data on separate occasions, was also tested by having one coder re-code two early transcripts, noting the reliability between the first and

research for which coding reliability is reported.⁴² Any disagreements between coders were discussed and mutually resolved. Similar to Malina and Selto (2001), sometimes resolution was to revise the definition of the code. Where mutual agreement could not be obtained a decision was made by a third person associated with the research. This was necessary for only two passages of data and this person's selected code was used for analysis.

After manual coding was complete, all transcripts were uploaded into NVivo (a computer software package for qualitative data analysis) and codes were applied electronically to the transcripts. The use of a qualitative data software package provides benefits to the research as it reduces researcher and reporting bias (Abernethy et al., 2005), and adds rigour and validity to the research (Bedard et al., 2012). This is due to a package's ability to ensure all data is coded; data is easily retrievable (saving time and potential omissions of data); provides ease of data comparison and movement between levels of analysis; and provides an audit trail of analysis (Abernethy et al., 2005; Miles and Huberman, 1994, p. 465). It is noted, the program was not used to automatically generate analyses.

3.6.2 ANALYSIS OVERVIEW

Two approaches to data analysis were undertaken. Firstly, a count of the frequency that each quality characteristic was mentioned by respondents (counted to a maximum of one for each respondent); and secondly, an interpretative analysis of the perceived importance of each characteristic was applied to the data. Both approaches were chosen as "It could be inferred that those categories chosen more frequently (i.e.

second attempts. This process was conducted over three weeks after final coding was conducted and resulted in agreement of 93%. The time between the first and second coding and the length and number of transcripts, was large enough that the chance of coding by memory was minimal (Malina and Selto, 2001).

⁴² For example, 88% (Cohen et al., 2010), 80% (Cohen et al., 2002), 80% (McCracken et al., 2008), 89% (Trompeter and Wright, 2010).

by more respondents) are more important. However, a simple count of the frequency of coding does not reflect the importance a particular respondent would assign to a particular factor” (Emby and Gibbins, 1988, p. 295).

The above coding procedure helps to identify key themes in the data, yet the content of data is often still very large. Researchers can rely on tables to summarise and tabulate the data (Eisenhardt, 1989b; Miles and Huberman, 1994, p. 11) and compress the data into an ordered form (Gendron, 2002). Based on the coded data, the researcher developed structured summaries of each participant and each code presented in the codebook. Tables and displays were developed off these summaries and used to provide a base for comparative analysis. For each participant a matrix was developed identifying the key themes discussed by that individual. The same process was used for each group of participants where a conceptual matrix was developed summarizing each of the individuals to identify key themes across groups. This aided the researcher to consider all data and observe both commonalities and differences within the data.

To identify themes, interviewee responses were analysed for common elements. These findings were then interpreted using pattern matching (Yin, 2009) considering the identified themes relative to both the theoretical framework of IAF quality and the multiple corporate governance theories. The researcher attempted to verify all conclusions by searching for contradictory data to limit incorrect, inconclusive or biased findings (Eisenhardt, 1989b). Variations or contradictory data are presented as alternative arguments in the findings.

Sensitivity analyses was conducted by comparing high and low quality examples provided across participants to find if factors of IAF quality are different when IAF quality is assessed as high or when assessed as low. Other sensitivity analyses were conducted on large versus small internal audit departments and regulated versus non-

regulated industries, to identify any potential differences in responses based on these underlying characteristics. There were no major variations found via these analyses.

The purpose of analysis is to present a blend of themes, quotes from participants, the author's interpretation of quotes, numerical results and consideration of multiple theoretical perspectives (Hermanson et al., 2012) to provide insight into the phenomenon of IAF quality. Further, given the approaches made to limit concerns of validity and reliability, the extant group of experienced professional participants and the analytical process carried out, it is perceived that the methodological process taken provides a balance of rigour and openness called for by Gendron (2009) and Radcliffe (2010) in qualitative accounting research.

Chapters 4 and 5 present the findings generated via the 36 semi-structured interviews with IAF stakeholders. Chapter 4 addresses RQ1 and RQ2 about stakeholder judgment of IAF quality. Chapter 5 addresses RQ3 about factors considered as determinants to a quality IAF. The following information is pertinent to the results presented in both chapters. Firstly, abbreviations are used to identify the different participant groups as outlined in Section 3.3.1 (AC, SM, IA Head, and IA Partner). Secondly, questions posed to participants asked them to recall experiences with higher and lower quality internal audit engagements and discuss these experiences. Both chapters present quotes from these experiences to support the findings made. However, after participants discussed their experience, they often described their insights in more general statements. Many of these statements are used to also support the findings. The importance of the questions was to invoke the participants' experiences; therefore, general statements are related to their recalled experience. Further, as responses are experience based, insights from each participant may not be exhaustive; that is, participants were not asked to list all components of quality or information cues.

Chapter 4: Findings and Discussion: RQ1 and RQ2

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4.1 INTRODUCTION

This chapter presents the findings for RQ1 and RQ2 and provides a discussion on these findings. RQ1 investigates if different IAF stakeholders make judgments on IAF quality differently and RQ2 investigates the main information cues used by IAF stakeholders to judge IAF quality. Findings suggest that participants do make judgements on IAF quality differently. The main information cues used to assess IAF quality vary among each of the four groups, and are based on various process, output and outcome dimensions. The discussion section of this chapter compares the differences among each group, relates findings to prior literature, discusses the implications of these findings, and frames the findings in the rubric of corporate governance theories.

Table 6: Participant Abbreviations

Abbreviation	Position
AC	Audit committee member/chair
SM	Senior manager
IA Head	Head of in-house internal audit department
IA Partner	Partner of internal audit division from an accounting firm

4.2 FINDINGS – RQ1

RQ1 investigates if the different IAF stakeholder groups judge IAF quality differently. The findings to this research question are inferred from results of RQ2, which discusses the IAF quality judgments of each of the four stakeholder groups. The analysis of participants responses to RQ2 (discussed below) suggests variations in stakeholder groups' judgments of IAF quality. The four different groups used either, or a combination of, the process, output or outcome dimensions comprised in the IAF quality framework. Specifically, ACs judge IAF quality via outputs; SMs predominantly via outcomes, and secondarily via outputs. Within the provider groups, IA Heads judge IAF quality via processes; and, IA Partners judge via both outputs and outcomes. Figure 5 provides an overview of different dimensions used in the judgment of IAF quality by the four stakeholder groups. External auditors have been included in the figure to indicate that their judgment of IAF quality is different to other IAF stakeholders. Again, how these results were determined is the emphasis under RQ2.

Figure 5: IAF Stakeholder Judgment Dimensions

	AC	SM	IA Head	IA Partner	External Auditor ^a
Input					
Process					
Output					
Outcome					

^a External auditor judgment dimension included for comparative purposes only.

4.3 FINDINGS – RQ2

RQ2 addresses what are the main information cues used by IAF stakeholders to judge IAF quality. This section presents the findings for the four stakeholder groups. The information cues used by the IAF stakeholders to judge IAF quality are summarised below in Table 7. The information cues used are separated into primary information cues and secondary information cues where this weighting was identified in participant responses. All information cues are discussed in detail in this section.

Table 7: Information Cues Used to Judge IAF Quality

Stakeholder	Primary Information Cue(s)	Secondary Information Cue(s)
Audit Committee	IAF reports (output)	Quality views of other stakeholders (outcome) ^a
Senior Management	Value from the audit (outcome)	Findings and recommendations (output)
IA Heads	Completeness of the audit (process)	
IA Partners	IAF reports (output) Value provided to the client (outcome)	

^a While this information cue could be considered as an input to an audit committee's IAF judgment, it is an outcome of the IAF having been conducted.

4.3.1 AUDIT COMMITTEE

A consistent sentiment among AC participants is that they observe little about how an audit is performed, exemplified in the following comment:

Well as an Audit Committee member, you don't see much about the way the audit is done. (AC)

As a result, audit committee members can only rely on what information is available to them for making their judgment of IAF quality. The information used by ACs to judge the quality of the IAF clearly fell under two distinct cues. First the outputs of the IAF in the form of IAF reports, and second, the views held by other IAF stakeholders as to the quality of the IAF.

Each AC participant indicated the predominant cue used in their judgement of IAF quality is IAF outputs. This includes the quality and substance of reports, the quality of findings, and any presentation of findings to the audit committee. Thus, the quality of reports are a significant cue for ACs to assess IAF quality, as highlighted by the following AC:

It probably comes back more so to the quality of commentary than anything else. One feature of internal audit is that it is much more free form than external audit and so therefore just about every person almost, and certainly every internal audit group, seems to want to do things differently. So it is relatively difficult to assess whether or not the internal audit itself is a quality job. (AC)

This AC identifies that it is difficult to assess the quality of an internal audit due to the diversity of IAFs across organisations, and diversity of audit engagements. As such, this AC suggests that the quality of reports are therefore used to judge IAF quality.

Reports contain the IAF's findings and the quality of these findings were specified by ACs as the greatest indicator of IAF quality and the predominant information cue used within IAF reports. For example, in discussing why an audit was of high quality the following AC illustrates the importance of findings on quality assessments:

Because of basically what it uncovered. You know you really can't tell what is a high or what is a low quality audit. If it is a clean audit, then you can't be sure that he hasn't missed something. But certainly if he has done an audit and you have lots of findings that are fairly damaging, then that to my mind is - excepting the quality of the internal auditor that he is going to provide an equal effort on all jobs, on all programs - then that is clear evidence of having done a quality audit. (AC)

This sentiment about the importance of findings is echoed by another AC statement:

You know from the reports that come to you ... as to the quality of the findings. I'd be very worried if [the IAF] found nothing, continually found nothing on most assignments. And sometimes the findings can be pretty assertoric you know - and so you say 'yeah he's digging, he understands what that is about'. If I kept getting reports that pretty much confirmed 'no problems, no problems, no problems, I thank management for their cooperation', I would be pretty nervous. But I know that you occasionally get that hard-hitting report and then you get other reports that come up with findings that would indicate yeah the guy is doing his job. So it is an overall feeling of quality rather than program by program, job by job. (AC)

The last quote identifies the importance of reports but also alludes that an IAF quality judgment is made over a collection of IAF reports, not just a single report.

The substance of reports influences the confidence of the audit committee that an IAF is of an acceptable level of quality. For instance, an AC referred to the lack of confidence he received from the IAF at a former company where he was the Audit Committee Chairman:

So we had an internal audit report on [the recording of inventory] which just did not address the issues. It just sort of skated over it ... it did not address the issues and certainly didn't point to how we could actually gain any confidence that we were accounting for the [inventory]. ... So just doing a report on the documentation or the end of the process, that wasn't going to do it. (AC)

The AC providing this quote emphasized that the report gave him/her no confidence in the internal auditor, or that the internal auditor was performing a quality role. The AC then compared this reporting to his/her current AC position where the IAF produces substantive reports focusing on the risks and implications for the audit committee and the business. This style of reporting was suggested to provide the audit committee greater comfort and an indication of higher IAF quality. Another AC provided a similar perspective based on comfort from the IAF report:

We had a couple of reports from the internal auditor prior to this one ... a couple of reports that, the work was probably done but I couldn't get a warm feeling from them because of the lack of structure, the structure that a professional internal auditor or an external auditor would expect – scope and the rest of it – and that was lacking. ... Structure is so critical to increasing your level of comfort with the work done; and even though with the other guy the result looked okay, you could never be absolutely certain that, there is no method, you can't be certain about the method that was followed. (AC)

The findings in reports also must have supporting evidence to provide an indication to the AC of the substance of the report. For example, an AC describes a report as a low quality report because it lacked substance and supporting evidence:

It was slip-shot in terms of professional presentation I guess and the thinking behind it. ... It was cavalier and I was unimpressed. So it is a

matter of having the support to back up the opinion they arrive at, or the recommendation they arrive at, or the assessment they arrive at. (AC)

The IAF's prioritisation and weighting of audit findings and business risks in reports is also an indication to the ACs of IAF quality. Many ACs commented on the process of how they look at these rankings and make a judgment on the quality of the IAF according to how they as an AC member would have prioritised the findings or risks. When ACs do not agree with the IAF's categorisation, the ACs have trouble viewing the IAF as high quality, as implied in the following excerpts:

Probably the single best index for me is that, you know characteristically they will categorise their findings in probably three boxes or maybe five boxes, but normally it is three – this is high risk, this is moderate, this is relatively low. If their judgement about categorisation consistently resonates with me, then I have a high degree of confidence in the audit team. But if they rate something that is moderate which I actually think is a very high risk, or they start picking up routine – I mean has anybody ever audited an I.T. function and came to the conclusion that passwords were changed often enough? No. And if you turn that into a high, except around maybe some very critical function like the Treasury function, then I say that you are not showing good judgement, that is unrealistic. ... So it's that consistency in the judgement. (AC)

As the chair of the audit committee you have got to be on top of it all, so I look at the reason that, the reasoning behind the facts that point to a high risk, moderate risk, low risk. So that needs to be pretty well supported; well, very well supported. (AC)

I read reports thoroughly and I look at the soundness of the reasoning. Where you get reports, you have effectively got to rely on the facts as stated in the reports. So what thinking goes into how you differentiate between what is a major risk, what is not so great, what is important – that would probably be the major way of assessing. (AC)

This AC continued:

I always have the internal auditor present at the Audit Committee meeting where a report is presented. ... So the combination of looking at the detail, and the logic, and the recommendation, that comes out of it [the report] combined with what effectively is a cross examination of the person or the people involved ... it has got to stand up. (AC)

This last quote identifies two ways in which the AC use reports as information cues relating to the quality of the IAF. First, the report itself and second the presentation of the report's findings. This process was mentioned by a number of ACs who indicated they make part of their judgment of the IAF based on the presentation of the findings (report) by internal auditors and how internal auditors conduct themselves in audit committee meetings. The presentation of the findings is important to ACs. Illustrating this point is a quote by one AC, who questioned the Chief Internal Auditor at a company where the AC had just taken on the role of Audit Committee Chairman. Along with major risks associated with the specific industry, this company has very large risks associated with previous employee fatalities (due to poor maintenance of equipment) and business interruptions (through being unable to meet capacity requirements). The internal auditor's response to the AC's question gave the AC a clear indication of the quality of this internal auditor:

I asked the auditor what was the major risk within the organisation that he thought the Board should be on top of. And this person turned around, and he said, 'you know your payroll system, there's not a manual check of some of the changes made to it' or something or other. And I just fell off my chair and had to pick myself up and resuscitate myself. Because here we are talking about an off-the-shelf payroll system – there is always some risk I guess – but it's at the edge compared to what we had in the business, and there was a total disconnect. So did I have any confidence in that person doing a proper audit of the organisation? Absolutely not. Did it give me any confidence in signing of the accounts that he had done the right work? Absolutely not. ... Because you know when you sign off the accounts you need to have some confidence around the level of controls; and if you have a weak internal audit, I don't think you can actually sign off. (AC)

The second information cue ACs consider in their judgment of IAF quality is the perceptions of other IAF stakeholders. ACs suggested that beyond judgment of IAF reports, they consider and incorporate the view of IAF quality from a number of their associates. These associates include the external auditor, the CEO and divisional management. For example:

When we were doing an external audit, we were asking them ‘how have they found internal audit?’ ... We ask the CEO ... and we also get a good view by talking to business unit heads. (AC)

What management think of them, what CEOs think of them, and what you think of them from what you have seen. So has there generally been positive feedback from what they [internal audit] have done, have there been any surprises. (AC)

These quotes imply the ACs are proactive and discuss quality of the IAF with a number of associates. Other ACs only discuss receiving the view from a single stakeholder, such as the external auditor:

It is part of our practice in any of the committees I sit on, that we will grill the external auditor about their view of the quality of [the] internal audit function; to what extent they were willing to place reliance on internal audit (and the finance function). So you do get a crosscheck and you are also using internal audit and the finance function to check the ambitions of your external auditor. (AC)

This quote indicates that this AC uses the views of others to assess the quality of various business functions, noting that they also use the IAF and their finance department to express opinions on the quality of the external auditor. This AC also states it is the practice of each audit committee of which they are a member. In contrast, the following AC, while suggesting it is a strong business practice to understand others’ views of IAF quality, suggests that it is not common in his/her experience:

The Managing Director does a performance review of the internal auditor which he shares with the Audit Committee on at least an annual basis. And the Audit Committee ... provides its views on the effectiveness of the internal auditor and internal audit function to the Managing Director; so it's an interactive session. It's the only Board where we do that, and I sit on eight; and I think that is probably the most mature in terms of having gone to that extent. (AC)

Related to using the views of others in the assessment of IAF quality, some ACs suggest that management’s acceptance of the IAF and IAF recommendations is an

adverse indicator they use in their judgment of IAF quality. Again, noting how ACs have limited views of how each audit is conducted (the audit process) an AC suggested:

If you hear back that either management refuses to respond in a timely way to recommendations, or rejects a number of the recommendations and you get stuck with what looks like a lot of compromises, that tends to be the evidence that says this isn't going well. (AC)

This AC continued his/her discussion with an example of when management accepted recommendations and agreed to implement each recommendation even though it was going to be very difficult. This acceptance by management indicated to the AC that the findings were obviously important and the IAF had performed a quality audit. This can be interpreted to mean that if the AC sees management disagreeing with, and not implementing, IAF recommendations then this is a sign that the IAF is performing at a lower level of quality. However, the ACs were cognisant that it is not always the fault of the internal auditor. Non-acceptance of recommendations can sometimes be a result of management being difficult. As a result, ACs often require management to provide reasons for their decision, indeed:

Another indication of course is whether management agrees or disagrees; and I always ask management to make sure that they either agree or they disagree and to tell me why they disagree because that is pretty important. (AC)

In summary, ACs use two information cues to make judgments on the quality of the IAF – reports and other stakeholder views. ACs generally only see IAF reports and presentations to the AC, therefore these outputs are a significant information cue for the AC. Quality reports provide confidence to the AC that the IAF is performing to a high standard of quality. Reports are judged on their findings (significance, insight, and focus on risks), their form and substance (presentation, structure, supporting evidence, and audit objectives addressed), and whether the prioritisation or ranking of findings and risks resonates with the AC's view. ACs gain confidence in IAF quality via presentation

of findings, and interaction, at audit committee meetings. The second information cue used by ACs is the views held by other IAF stakeholders as to the quality of the IAF, namely, the external auditors, executive management and divisional management.

4.3.2 SENIOR MANAGEMENT

SMs use two main information cues to judge IAF quality. The predominant information cue is the value created by the IAF. Value is derived from how the IAF has helped to improve the business, and is an outcome driven cue in judgment of IAF quality. Many SMs also consider the quality of IAF outputs, particularly findings and recommendations, as a secondary information cue to IAF quality.

The following quote from a SM suggests that an audit is not of low quality just because there are no major issues found, but they did judge the quality of a recent audit on the value and insight provided:

You can't really judge the quality of audit on recommendations because if you have a fantastic process and there are no recommendations, you can't say that wasn't a good audit. But there was just more value-add in terms of the issues that they raised and evidence of the recommendations at work. ... It just added value to our system and the way people manage the processes. And it's very practical too. (SM)

Similarly, another SM suggests that the IAF is judged on the value created, not merely on coming up with simple findings:

Specifically what they're going to be judged on in terms of performance ... it's not a matter of saying 'well yeah we've found a heap of non-compliant things'... well that's a given, you're going to do that, it's part of your job. But where can you add value to the business as a consequence of conducting your audit; you know, how will the business be better as a result of that audit having been conducted. (SM)

This quote suggests management perceive value when internal audit brings insight to the organisation that will improve business systems and performance. Another SM indicates they judge the quality of the IAF via the value that is produced, suggesting:

They [internal audit] need to look at the genuine issues and how they can improve the business. Business improvement is the key. I'm looking that they actually deliver insight to help improve the business, not just a bunch of little problems they have found. Just providing a list of small things that are really not going to improve anything, you know when they just try to find things to prove they can, or, little things that anyone could find, what are they adding to the business? But if you [internal audit] give me something that will save us, something we didn't know – "Wow. Great!" – That's when I'd see it as a quality audit. (SM)

This quote highlights how this SM views an IAF as being of high quality when the IAF produces findings that management are unaware of and that can really benefit the business. Similar to the previous quote, this quote suggests that value does not occur when the IAF simply identifies a number of non-compliant issues or issues that are trivial. Many SMs identified that low quality audits are caused by an IAF adopting a 'tick-the-box' or 'tick-and-flick' audit approach. That is, those audits which are just looking at whether an action was completed or not – the compliance with internal policies and procedures. For example, one SM indicated that they perceived an internal audit engagement to be of low quality because the IAF approach did not give management any value:

Basically, the audit lacked in its thoroughness. It was a more cursory, tick-the box audit. It didn't get to the important detail of what we really needed. (SM)

Another SM made mention of how the depth of the audit influences value and their respective judgment:

It's a question of whether the internal auditor ... whether they are just trying to tick boxes or whether they are really trying to add value. (SM)

Consistent with the general SM view that value created by the IAF leads to judgment of high IAF quality, the following SM indicates the value that comes out of the findings can also determine quality:

It's pretty simple. When they [internal audit] turn up with a bunch of findings and I can go 'yep, yep, yep, I agree; these are important', then that is a valuable internal audit and I would say they have done a quality job. I've had internal audit give me reports and I've thought why would you bother raising this, or this is just unrealistic and it's pretty obvious they haven't thought about the finding at all. (SM)

Many SMs provided examples of high quality audits emphasising the value produced by the IAF. For example, the following SM indicates that he/she made a judgment of IAF quality via the value produced and resulting outcomes that the IAF helped the business achieve; discussing their experience at a previous company:

The internal audit manager ... took a very strategic view, and a very strong risk management view, and was actually responsible for driving a significant improvement in project management activities right across [Organisation XYZ] as a means of improving cross functional/cross divisional communication on large projects which had significant financial risk. And my view would be that particular activity saved [Organisation XYZ] many millions of dollars over quite a short period, over a 2 to 5 year period. (SM)

SMs also provided discussion on some output factors of the IAF that influence their judgment of IAF quality. First, SMs indicated that recommendations provided by the IAF are influential to their view of quality and reliance on the IAF work. For example, an SM stated:

What would stop me relying on recommendations of the actions would be overkill. One of my criticisms of internal audit and risk officers in organisations, if I can be crass, it's the cover your ass syndrome. It's 'if I'm not sure, I want to cover my ass, put it in writing, so then I can point and say I told you if you'd done all those procedures you would have been safe'. To me, edging on the side of conservatism, way on the side of conservatism, can lead to inefficiency and result in unnecessary overhead. So if I'm given an internal audit report and I review something that I don't agree with, it would not be about the cost it would be about whether I think there is overkill - a number of the recommendations have been put on paper to address that issue; I want one or two, I don't want five or six. So that's where I would push back if we have so many recommendations that I think it is just overkill on an issue that I really don't think is a significant issue. (SM)

Secondly, SMs suggest the quality of the draft reports they are provided at the closeout stage of the audit provide an indication of the quality of the IAF and the potential value from the audit. One SM provided the following comment:

I know the contracts and tender audit is not very good. I mean I'm having I think version number five or six at the moment, and it will be version number seven before it will get to the audit and risk committee. And the first version when I received it, we were trying to read it and we didn't understand what they were trying to tell us. It was like a copy of a template taken from, I would call it a milk bar business, with some charts and whatever and we were just sitting there thinking what are they trying, what are they telling us? (SM)

The practicality of findings and recommendations was often raised by SMs as an indicator of the IAF's quality. One SM described this as auditing with common sense. This SM described the difference between their experience as an internal auditor over 30 years ago, when he/she believes auditors used more common-sense than auditors nowadays who mainly focus on rules and compliance, to the detriment of being practical:

As I say, in my thinking, it comes back to this whole thing about you have got to take a common sense view ... If I go back to my internal audit days, I know one of the things I used to do when I went out and do branch audits; before criticising managers, I would try and take into account things like if it is a small office. There is no point in saying yes you need two people in the office to back each other up and so that you don't get collusion, because it costs you more to do that than any frauds would be worth. So I would point it out but I would also give that contra argument; it's my obligation to point it out, but I can understand why you don't do it, and then management is able to make that balanced decision. Whereas now auditors would go in and they would say 'you need an extra person because the rule says you can't have collusion; you know if you leave yourself open without two people, then it is a much easier fraud to perpetrate'. So it is often common sense, I just come back to common sense on the whole thing. (SM)

To summarise, the predominant information cue used by SMs in their judgement of IAF quality is the value outcome created by the IAF. Value to the SM is where, as a result of the audit being conducted, the IAF has helped to add value by improving

business systems or processes, identified ways to reduce costs, or, provided insights that management were not aware of. SMs judgement of value often hinges on whether they perceive the IAF is attempting to add value or simply tick boxes. A secondary information cue used by SMs is the outputs of the audit such as the findings and recommendations. Practical findings and recommendations that will provide benefit to the business increases SM confidence that the IAF understands what they are doing and the IAF are attempting to provide value.

4.3.3 IA HEADS

IA Heads' judgment of IAF quality appears substantive and based on IAF processes. This group employs a notion of 'completeness' as their information cue in IAF quality assessment. Specifically, IA Heads look at how the IAF arrives at their findings to identify the quality of those findings and the audit. Hence, IA Heads' information cues for judging IAF quality are largely based on the soundness of the processes performed to achieve their output. The information cue of completeness is used to identify if the IAF has conducted the audit process properly to achieve accurate and supportable findings. That is, their view consists of whether the audit identifies the fundamental issue, the sufficiency of evidence to support their conclusion, and what else could explain the issue.

To identify completeness, an IA Heads' judgment comprises of questioning of the team performing the audit, questioning of themselves as the head of the IAF, and standing back at completion of the audit and reflecting over the audit. For example, a number of IA Heads indicated they ask a series of questions and if they are satisfied with responses, this indicates to them a high level of quality. As one IA Head explains:

I step back at the end and ask the questions: how have we got to that conclusion? What have we done? And have we tried this, and what about this? ... If you ask me what quality is, it's where that person then hasn't

had to go back and say ‘actually I haven't thought about that’; or when I have dug a little bit deeper, and [asked] ‘how did you test that, and if you found exceptions then what did you do?’ And the answer has come back ‘oh, maybe I should go and test some more’. Those are the ones that I think well that's probably not where I would want it to be. (IA Head)

Another IA Head commented on their process to assess completeness:

Is to question everything that my team and I look at and see as part of the audit – So what does this mean? Why does it mean that the issue is not there? How comfortable are we that that there is not an issue in everything that we pick up to do? (IA Head)

Many IA Heads suggest that often their assessment on the completeness of the audit is based on their intuition. Discussing intuition, the following IA Head suggested:

So I think that's important in terms of understanding what is a good quality audit versus a poor quality audit because you might go and audit an area and say ‘okay all risks were identified, all controls were in place at the process level’, but you may sit back and say ‘well hang on a sec, the culture of this area doesn't seem right’. (IA Head)

The following IA Head clearly articulates their use of intuition in assessing completeness:

Probably if I have had an audit where I just don't feel we have got to the bottom of something. That could be something where you are using quite a standard practice or a process – a payables or expense or something – and maybe the results come out and everything looks satisfactory, but I may be left with a feeling of have we really turned over the stones with this one ... just auditors intuition that we might not have got to the bottom of something. So there's nothing wrong with the approach, and everything has gone quite well, but you are left with that uneasy feeling of have we got to the bottom. (IA Head)

IA Heads also imply they look at performance specific criteria when assessing completeness. For example, an IA Head discussed how he/she makes a judgment on quality via conformance to the audit's objectives:

I would review the report ... looking through the scope of what we had set out to do and what the observations were and what the report has finally come up with in the context of what we have done. (IA Head)

Another IA Head indicated they make judgments via the completeness of processes including the appropriateness of the audit scope and the evidence to support findings:

Quality would be the scope of what they do and how well is it aligned to the risks in the business. ... So I suppose that's the scope, and the breadth, are they looking at the right things? Then you get into the quality of the work, how well have they done the work and how well have they documented it, and I guess you can only really do that by [reviewing the] documentation. (IA Head)

The notion of completeness is again evident in the following quote by an IA Head who described their detailed process of forming a quality judgment of the internal audit:

That the audit test meets the objectives, so it actually addresses the key risks. So if an audit finding and audit work doesn't address the key risks it cannot be of high quality – I would say that that is probably the most important criteria. Second, there needs to be a proper analysis of the findings; so it has to identify the root cause or causes – because many audit findings, if you take 50 audit reports you will find that half of them have not identified the real root cause. It needs to be analysed in terms of the full consequence of the particular finding, you need to understand what the consequences are, the so what; if the consequences are immaterial you shouldn't actually have a finding. Then there needs to be sufficient evidence, so the evidence should stand on its own. ... No line managers should be able to challenge the finding because there should be sufficient evidence, it should be complete, accurate and valid in terms of the supporting evidence. ... Consequences should be fully scoped and calculated, and not stuff like 'there is a risk of fraud'; you know it wouldn't be a consequence for me. A consequence should be analysed if there is a risk of fraud, the auditors should actually determine whether fraud has taken place and you should actually follow that through, because otherwise the finding would be incomplete. (IA Head)

Evident from the quotes reported, IA Heads use a rather collective assessment of a number of process factors. Most importantly is, has the IAF identified the 'real' issue? The real issue is perceived to be identified when the scope is correct; the IAF team has used a rigorous methodology, gone deep enough in their investigation and collected evidence to support their conclusions; the IAF addresses all steps to meet their objectives; and there is effective engagement with the business, and in particular the executives, in order to aid the IAF's understanding.

IA Heads identified that through completeness the IAF is judged as being of high quality. They further indicated that when the IAF is of high quality, this is when the IAF can add value to the business. IA Heads clearly specified that creating value is the IAF's ultimate objective, however, value created is not the information cue IA Heads use to judge IAF quality. Interestingly while IA Heads clearly identified completeness as the key to judge IAF quality, they often recalled previous high quality audits as those that had provided value to the client, as the following quote illustrates:

But where at the end of it you come out with a result and can say, and management also say 'well we didn't know, that is terrific, that is exactly what we want you to do'. Those are the ones that I would remember as being quality and really making a difference. (IA Head)

Not all IA Heads consider completeness as the key information cue to judge IAF quality. Two IA Heads provide alternative information cues as most important to them for IAF quality judgments. One IA Head provides the following perspective:

Well, it's just going back to again I think having the qualifications and the skills. ... [and] having to follow those professional standards [IIA & Accounting] ... so I think that's the first quality measure. (IA Head)

Here the interviewee relies on two factors in measuring IAF quality. The first is the competence of the internal auditor (an input attribute). The second is the process of performing the audit in conformance with professional standards, both internal auditing standards and external audit standards.

The second IA Head who uses an alternative information cue suggests their view, and assessment, of IAF quality is orientated under a service professional view, indicating quality will be different for different users and that overall quality is meeting their most important stakeholder needs:

Stakeholders ultimately use internal audit for different purposes, they want different things and so often it makes it difficult as the audit

executive. But I'd have to say that it comes down to, quality is about what the audit committee chairman wants. (IA Head)

In summary, IA Heads use a notion of completeness as their information cue to IAF quality. Completeness entails: the quality of internal audit's processes (scope, methodology, depth audited to; engagement of business personnel and executives); whether the conclusion is correct and the fundamental issue (root cause) is identified, what supports this conclusion, and could it be explained by something else. Completeness is identified via questioning of the team about their processes employed, contemplation by the IA Head throughout, and at the end of, the audit, and the IA Head's intuition. IA Heads identified that value to the client is their ultimate objective, but do not appear to commonly use value as an information cue to judge IAF quality. Their judgment is based on completeness of the audit. When the IAF is 'complete' the audit is considered as high quality, which will add value to the client.

4.3.4 IA PARTNERS

There were two main information cues used for an IA Partners' judgment of IAF quality. The first cue is the reports produced by their team and the second cue is the value internal audit provides to their clients. These information cues used by IA Partners are largely output and outcome based. IA Partners are also very mindful that in order to make a judgment of IAF quality, it is important to first understand the client's view of quality.

IA Partners recognise that reports are internal audits' deliverable product. They also recognise that the reports are what the client sees and are likely to be the basis of clients' quality judgments. Therefore, reports are considered very important to IA Partners in assessing IAF quality. The following IA Partner's perspective elaborates on this sentiment:

Often the clients, they don't see, you know they don't really see the testing so their judgement of quality is on what does the output of the report look like. Is it well written, concise, does it convey the issues properly? And again, that sort of, for internal audit that is your deliverable. That is the quality. And what's that report look like, what sort of value does it give the client? (IA Partner)

A noticeable feature of this quote is the emergence of the concept of value, and the value that a client receives from an audit report. Another IA Partner provides an analogy for why outputs, such as reports, should be used in the judgment of IAF quality. This IA Partner links outputs to quality and value, as the output is the deliverable:

I often say to people: if you are selling a car, you don't see car adverts showing you pictures of the engine. What they show you is this beautiful car driving down a winding road in the Alps, and it looks fantastic, and wind through the hair. It's all about the final product and how it makes you feel and that sort of stuff. You know, they don't pick apart the engine and show how everything connects together and all that sort of stuff. And often I think internal audit can get a bit stuck in that sort of internal imagination aspects of it. I still think at the end of the day, a lot of it is, what value are you giving? And value is different to different people, so you have to define that. (IA Partner)

These last quotes identify both information cues used by IA Partners – reports and client value – and provide a link between the two. The comment below provides a typical perspective on the use of reports as an information cue of IAF quality:

It's really around the reporting. If I read this report as I say, what is the recipient of this going to think? Is this insightful, is this giving useful information? Does it leave questions unanswered? So for me, a lot of it is in that reading of the outputs that have come, and that is where 80% of the things I would raise where we either have to go back and do some more work or investigate more, annotate something, comes from is that in-depth reading of the report with that sort of mindset. That's the key element. ... And look in some cases we go out to organisations that have got very good controls, and the report may not say very much at all. However, as long as I'm satisfied in my own mind that there is not very much said because there is very little to say; you know we don't have to say stuff for the sake of saying it, then I'm sort of happy about that. But I think it's really, are there any questions left in there? Such that if you read something and say 'yeah, and, what else?' (IA Partner)

Reports are also used as an information cue to IAF quality as they are indicative of performance. That is, reports indicate to IA Partners the quality of multiple aspects of the audit, including processes used throughout the audit, the findings that have been raised and of the auditors performing the audit. The following two quotes are examples provided by IA Partners when they judged an audit to be of low quality based on their view of the reports quality:

The report that came out of this, I was not comfortable with the depth to which [internal audit] had challenged the organisation, or the recommendations they'd made; and in fact I addressed that with the CEO at the time and said "listen, we've done this, we've wasted some of your time but we're not going to issue this report". (IA Partner)

That you can actually pick up the report and understand what the issue is would be an indicator of high quality. Where there is enough, where it tells a story, the actual findings that you're detailing actually provide enough evidence for people to understand what the issue is. So for instance, I reviewed a report yesterday ... it was hard to understand from that finding that whether it was because [of a data issue] or whether the system itself had an issue. ... That was a poor quality report because if I was a member of the audit committee, I'd look at that and go 'well have we got a system issue that we need to be fixing or did we not do appropriate reconciliation checking over that balances that were brought across?' (IA Partner)

The above two quotes highlight the consumer perspective taken by IA Partners to reports and the quality of the IAF.

Evidenced in the following statements by IA Partners is that reports are indicative of the quality of an auditors' understanding and the processes (level of analysis) they employ:

A person who is working off a checklist as opposed to absolute in-depth understanding and knowledge – that is very quickly reflected in the quality of findings to be honest. So you can see, you will quite often, you could pick up two reports and you can tell which one has been done by someone with a real in-depth understanding. (IA Partner)

Say our teams have gone and tested a typical thing, tested 100 timesheets and five or 10 weren't approved or didn't bear evidence of approval, you know a pretty vanilla sort of a situation. In my opinion, a pretty average report says 'we tested 100, five or 10 weren't approved or bore evidence of approval. Recommendation – reinforce people to have them approved'. That is really lame to me. You compare that then, a better report and a better outcome is then root cause analysis. So why is it that those 10 weren't signed? Is it a lack of training? Is there a lack of commitment to controls? Is there a lack of understanding as to why it is important? So if we understand the root cause far better, you can come up with a far better recommendation ... So for me it is the level of thinking and rigour around what is the real issue here to then enable a better recommendation which will enable change. To me that is a test I use. (IA Partner)

Another IA Partner elaborates on the importance of reports for assessing IAF quality:

Low quality audits tend to be things where, and I'd say in the most part tend to manifest themselves in the execution and reporting. ... So you get your client criticising you by saying, 'I agree with your observation, but your implications or your recommendations I don't agree with; I don't think they are practical, commercial, there's no insight'. To me, that's when I think about a low quality engagement, we haven't given the client anything of value – that to me is low quality. (IA Partner)

Two insights into IAF quality information cues are provided in this quote, management's response and client value. This quote – and a few others – implies that management's response to IAF reports (including findings and recommendations) is an indication of quality, as predominantly a negative reaction by management is caused by a low quality audit. When the IAF have performed to a high level of quality, management are very likely to address the finding or action the recommendation(s). The more salient feature of the above quote is that the IA Partner links the quality of the IAF output with the value provided to the client. This link – the relationship between a quality report and the value to clients – has been illustrated in other quotes presented above. Most IA Partner participants justify their assessment of IAF reports based on the value the report will provide to the client. For example, the following quote from an IA Partner reflects on what they consider to be high quality audits that their firm has

conducted. The IA Partner combines the reports (findings and articulation) with the value received by the client as indicative of high quality internal audit engagements:

So when I think of what we've done with clients that [the audits'] were of high quality, we've tended to identify things that they weren't aware of. We've articulated really well. It's given them something to action to improve their business, to close control gaps, to improve business performance, that sort of thing. You know it has saved the company some money. That's what I would judge to be a high quality audit. (IA Partner)

Not only do IA Partners make a link between quality reports and value, but many IA Partners discussed value and quality interchangeably, suggesting the two are inextricably linked. Consider the following two quotes:

We generally discuss internal audit in regards of value instead of the term quality; the value the clients get from internal audit. We ask ourselves these questions: What do we do that adds value to the organisation? What can we do to add greater value? ... However, the two terms are almost interchangeable; they are factors of one another. You can hardly add value, or see value, when the audit is not of high quality. It is also difficult to have a high quality audit that doesn't add value – but you have to be careful here, if the audit is not focused and the scope set out and the objectives of the audit, this is where a high quality audit cannot add value. ... The ability to add value is how I would consider quality. (IA Partner)

I think the question of value and quality are inextricably linked. ... If the client gets value, I think, by definition it's highly likely that you've performed the audit to a high degree of quality; and the converse is true – not an absolute rule, but to me that would be the way. In the most part it would be hard to give a high value output if you didn't have a quality audit process to back it up – not always true, you can be lucky. (IA Partner)

The value provided to the client is a driving force in IA Partners' judgments on the quality of the IAF, as implied by the following excerpt:

As a professional services firm, one of the key drivers for us is, is our client happy at the end of the day with what we have given them? So in theory, you could do a technically high quality audit and the client isn't particularly over the moon with the outcomes. Equally, there is a model where technically it's not the best and the client can still be very happy with the outputs. ... So in terms of what's a high quality, part of what I

think is, is my client happy at the end of the day with the outcomes they've received? (IA Partner)

This quote assumes that if the client is not happy with the audit, the client has likely not received value from the audit; therefore, it would be difficult to consider the audit as being of high quality. The suggestion here is that even though the audit could be technically perfect and high quality from an IAF standpoint, in reality the audit is not of high quality when it has not met the customers' needs by adding value. This same IA Partner commented:

Clients will have different expectations of what they want their internal audit functions to deliver, and what they expect from internal audit. So some organisations want a very high focus on checks and balances, compliance, that sort of thing – and that's fine. Others see it much more as we want internal audit to add value to our processes and management, and help us improve; so it's much less focused on compliance, almost like an internal consultant type model. (IA Partner)

IA Partners consistently raised this sentiment of knowing and understanding both the client's expectations of the audit and their views of quality. IA Partners argue that client expectations must be taken into consideration when making judgments on quality. The following two quotes also suggest IA Partners are cognisant that clients want different things from the audit:

The first thing you need to do is find what people mean by quality in internal audit engagements. And that comes down, I think, to understanding what different stakeholders want from that particular engagement. ... So the quality judgement comes down to understanding what each of those stakeholders would expect in terms of the outcomes and whether there is sufficient depth that goes into achieving those outcomes. (IA Partner)

You would have to start with who are the owners or the clients of internal audit. Well there is the shareholders to an extent, there is the board, there is management. And that differs to external audit where management is a mere stakeholder not customer, that's clear. So the dynamic is a little bit different. So if we stand back and say what does each want, they are roughly aligned but not necessarily always. So quality for those three different groups, certainly the two: directors and management, would have some differences. (IA Partner)

As these comments reveal, IA Partners understand different clients may have different expectations which need to be considered when making an assessment of IAF quality. Again, this reveals the service perspective to quality taken by IA Partners.

In summary, IA Partners rely on two information cues in their judgment of IAF quality – IAF reports and the value received by the client. The view of IA Partners is that quality is about the final product; therefore, they use IAF outputs and outcomes in their judgment of quality. IA Partners use reports as an information cue as reports are their deliverable. Reports provide the IA Partner with an indication of the value that clients will receive and indicate the efficacy of audit’s performance and understanding. The second cue is the value received by the client, including does the client get what they want (i.e. something to improve the business they were not aware of) and is the client happy. IA Partners often discussed quality and value interchangeably suggesting they are inextricably linked. IA Partners also recognise that to make a judgment on IAF quality, the client’s expectations must be known and understood.

4.4 DISCUSSION

RQ1 investigates if the different IAF stakeholders judge the quality of the IAF differently. The analysis of participant responses establishes that the AC, SM, IA Heads and IA Partners each judge IAF quality differently as they each rely on different information cues. The information cues used by the groups are based on different dimensions within the IAF quality framework, including: processes, outputs and outcomes. The findings also demonstrate that the stakeholder groups in this study judge IAF quality differently compared with how the external auditor judges IAF quality. As established in prior research and prescribed in external audit standards, the external auditor judges IAF quality based on inputs to the function. Figure 5 provides an

overview of the IAF stakeholder groups' collective judgments, which represent different dimensions within the IAF quality framework.

This analysis shows that even within the two IAF user groups and the two IAF provider groups, judgments are different. For instance, IA Heads judge via the process dimension, whereas IA Partners rely on outputs and outcome dimensions for their judgments. The user groups were more similar, both using outputs and outcomes, however, ACs predominantly used outputs, while the SMs predominantly used outcomes. Stakeholders were expected to judge IAF quality differently as quality is contingent on stakeholder needs and objectives which differ across stakeholders (Aguilera et al., 2008; Cohen et al., 2004). Therefore, it is not surprising to find differences between the AC group and the SM group, and between these two user groups and the providers. However, interestingly, the providers' judgments were quite different. IA Partners appear to be more closely aligned in their judgments with the user groups than IA Heads, based on the use of output and outcome dimensions for judgment. Potential reasons for these differences and the potential driving forces behind judgments of IAF quality based on theoretical reasoning is addressed in the discussion for RQ2.

RQ2 explores the main information cues used by IAF stakeholders to judge IAF quality. Summaries of the information cues were presented for each group earlier in the chapter. This discussion examines the broader issue of these information cues in the context of corporate governance and their consistency with corporate governance theoretical underpinnings (Cohen et al., 2008). The discussion also relates the findings to the overarching research question of this thesis 'What is IAF quality?'

4.4.1 AUDIT COMMITTEE

The two information cues used by the AC are IAF reports and the other stakeholder views of IAF quality. Thus, ACs use both evaluation (reports) and search (views of others) strategies to judge IAF quality (Einhorn and Hogarth, 1981). Overall, the ACs contend that a quality IAF focuses on the key risks of the organisation to attain the audit committee's strategic objectives and the strategic objectives of management. The key risks include financial, strategic and operational risks. A quality internal audit is a comfort to the AC adding value to their monitoring role; however, a quality IAF provides comfort to the AC not only that management are doing the right thing, but also provides insight into improving the business. The ACs suggested that reports are the best indicator of whether there has been a focus on key risks and the attainment of objectives. Therefore, reports are the main information cue for the AC to judge the quality of the IAF. The finding is consistent with those of Deumes et al. (2012) that in an audit committee's monitoring role of the external auditor, the main criteria used are external auditor reports and communication.

The ACs use reports as a source of comfort regarding the level of IAF quality. To provide comfort, and to be considered of high quality, reports must contain the key risks, what these risks mean to the organisation, and what actions the AC and others need to take. Reports also give the AC confidence in internal auditor judgments and processes, along with their understanding. For example, ACs indicated they look at the soundness of internal auditors' judgments and understanding via their categorisation and weighting of risks and findings, and how the internal auditors' views resonate with their own. Deumes et al. (2012) also find audit committees use their experience and expertise to assess the judgements of the external auditor and hence external audit quality. The degree of comfort with the quality of the IAF gained from reports is increased by face-

to-face interactions and IAF presentations where the AC can confirm their judgement and increase their confidence in IAF quality. The use of audit committee meetings and auditor presentations is also used by audit committees to establish the credibility of external auditors (Gendron et al., 2004).

From the substantial effort ACs put in their judgment of IAF quality based on reports, their emphasis on finding comfort from the IAF, and examining if the IAF focuses on key organisational risks, it appears that the AC takes a strong monitoring approach in regard to judging IAF quality consistent with prescriptions of agency theory. In addition, the ACs view quality IAFs as focused on more than just strategic financial risks, and include operational risks and helping management achieve their strategic objectives and process improvement (Cohen et al., 2010), suggests AC judgments of IAF quality are also motivated by a resource dependency perspective.

The second information cue used by ACs is the view held by other IAF stakeholders including executive and departmental managers and the external auditor. This is an indirect cue used by the AC, but consistent with findings by Gendron and Bédard (2006) and Beasley et al. (2009) that ACs use informal practices to help fulfil their obligations. Similarly, Deumes et al. (2012) find audit committees rely on information from management to assess external audit quality. There was some diversity in the use of this practice, with some ACs suggesting it is used on every board they were a member of, while others saw it used less but perceive it as a mature process for ACs and a leading innovation.

Under the agency perspective of monitoring management, an AC asking management their view of IAF quality seems a poor process as management's independence is likely impaired. This process seems more consistent with a resource dependency perspective by checking whether the IAF are providing management with

insights to achieve their strategic objectives. There is even some suggestion that this process can be explained by an institutional theory perspective where the AC are fulfilling their duty to judge IAF quality in ‘form’ (Cohen et al., 2008) by simply asking others for their judgment. However, in the context of the findings of this research question, that is, the substantial effort demonstrated by ACs in making judgments about IAF quality, along with their incentives to minimise legal and reputational risk (Beasley et al., 2009; Srinivasan, 2005), this informal practice appears to be used as confirmatory evidence by the AC to increase their confidence in their IAF quality judgment. Therefore, fulfilling their role in ‘substance’ and again being viewed under an agency perspective (Cohen et al., 2008). Examining the weighting this process carries in an AC’s judgment is an interesting area for future research.

The findings of RQ2 suggest that both an agency and resource dependency perspective motivate an AC’s judgments of IAF quality. For instance, the following example shows clearly an agency perspective based on the risk to directors (Cohen et al., 2013a):

At the end of the day, the primary reason we have internal audit is to give the Board the confidence to sign statements and accept the risks that go with being a director these days, which are not inconsiderable, and one is fairly conscious of it. (AC)

While this quote infers that the AC takes an agency perspective for their own comfort considering their reputational and legal risks (Beasley et al., 2009; Srinivasan, 2005), the agency perspective also considered acting in the interest, and protection, of shareholders (Beasley et al., 2009). Other ACs were more explicit in the resource dependency perspective in relation to IAF quality:

I would say that a quality internal audit is one that provides good commentary back to management about the efficacy of their systems and the efficiency of their systems and whether or not their systems are actually going to achieve what they want to do. (AC)

However, the majority considered both perspectives. For instance, the following quote considers independence necessary under an agency perspective (Hermanson et al., 2012) and being a partner to management (Cohen et al., 2008):

Internal auditors need to understand that they have to be independent but they are a partner to management in providing value to the business.
(AC)

Lastly, ACs inferred that they asymmetrically interpret signals from reports. Reports with ‘no findings’ are often a negative quality signal to ACs, with ACs suggesting that no findings create some concern over the quality of the IAF performance. However, this concern can be mitigated over a number of reports as ACs realise sometimes there will be no findings in the report simply because there were no evolving issues from the audit. On the other hand, having findings can be a positive or negative signal, depending on the substance of the findings. This raises two interesting points; first, that ACs make judgments both over single audit engagements and over a collection of audits. Second, how one judges IAF quality may have a negative impact on future audits. For instance, if an IAF knows they will be judged based on an ‘amount’ of findings, they may feel forced to also include low level findings just to be able to have additional findings in the report, which in turn may create lower assessments of IAF quality from the report recipient.

4.4.2 SENIOR MANAGEMENT

The two information cues used by SM participants to judge IAF quality are the value created by the IAF and the IAF outputs such as findings and recommendations. SMs view the IAF as a resource to help them with uncertainty about risks, provide insight to what management does not know, and to help make business improvements so that management can achieve their objectives. SMs also expect the IAF to take a strategic view to the audit, and work collaboratively as a team with management. SMs

see the internal audit as high quality when the audit creates value for the SM's role or the organisation. The value created for management includes improvements to systems, processes, performance, cost savings and risk reductions. When an IAF creates value and helps management with their objectives, they are viewed as being of high quality as the business will be better as a result of the audit being conducted. With quality being judged by value creation, this view is consistent with a resource dependency perspective (Cohen et al., 2008).

The second information cue for SMs is the quality of findings and recommendations. SM's assess the quality of findings and recommendations as they are an indication of the value potentially forthcoming and they increase their confidence that value will be created. So again, the focus of value in achieving objectives is consistent with a resource dependency perspective.

SMs also play a role in overseeing employees; therefore, there is an aspect of a monitoring role for management within the organisation. However, there was little evidence to suggest this was part of a SM's judgment of quality. SM's did not see value in internal-compliance type audits and many suggested they do not see value in the IAF auditing financial reporting activities as the external auditors are doing this. SMs were adamant that quality and value is about strategic and operational objectives and risks. A number of SMs indicated they found it rare for the IAF to add value; therefore their perceptions and judgments are that the IAF is not of high quality. If management are not proactive about improving the IAF to add value, then there is an indication of an institutional theory perspective where management just tolerates the IAF to symbolise they are following good governance practices and/or regulatory requirements (Hermanson et al., 2012) to provide external legitimacy (Beasley et al., 2009).

4.4.3 IA HEADS

IA Heads employ a notion of completeness as their main information cue used to judge the quality of an IAF. Completeness of the audit is used as it provides IA Heads with confidence that what they deliver to their clients will be valuable and enhance the business in a positive way. IA Heads clearly recognised that adding value is their ultimate objective and question what changes will occur as a result of the audit being conducted. This information cue and objective is consistent with prescriptions of a stewardship theoretical perspective (Nicholson and Kiel, 2007). A stewardship view entails the actor focusing on promoting value and organisational improvement (Beasley et al., 2009). The IA Heads' emphasis on the soundness and completeness of the audit engagement to create a quality audit shows signs that IA Heads are motivated to do the best for the organisation and align with organisational objectives (Davis et al., 1997; Nicholson and Kiel, 2007). Part of the driving motivation for an IA Head to be aligned with organisational goals and preserving the organisation appears in a psychological attachment and identification as part of the firm (Stefaniak et al., 2012). The steward perspective and identification is evident in the following quote:

I think the quality aspect is ingrained in the whole audit process to a large degree. Simply because I think we have learned from our past, that if anything will go wrong in the business, it's not that the business has failed to pick that up, it's also our responsibility to have thought about that from a risk sense as well, and have told the business to think about that as well. So I think we take it quite seriously as if we are in management's shoes, to ensure nothing serious goes wrong. And we apply the same mindset I think, which is important, that when we are out auditing that we focus on absolutely key risks that would bring [Organisation XYZ] down, or would cause us reputation damage, or be a major issue if we don't think about all those risks. So we take that mindset. (IA Head)

IA Head motivation may also be driven by their need to protect their own reputation and that of the IAF as a whole (Nicholson and Kiel, 2007) as completeness indicates that they have done everything in their power to conduct a quality audit.

Finally, IA Heads discussed a number of aspects contributing to their notion of completeness. These included ‘getting to the bottom’ of an issue or identifying the root cause, identifying the ‘real’ issue, meeting stakeholder audit objectives, addressing the key risks of the organisation, the soundness of processes and relevance to the organisation. This information cue used by IA Heads is very similar to the measurement of quality in the information systems literature (Wang and Strong, 1996) (Section 2.3.2).

4.4.4 IA PARTNERS

IA Partners used two main information cues in their judgment of IAF quality, the reports produced and the value created for the client. IA Partners consider reports and value in quality assessments as they recognise this is how clients will most likely make judgments of quality. Reports are considered according to how the recipient will receive value and how the report will make the recipient feel. IA Partners indicated they put themselves ‘in the shoes of management’ when judging reports, to ensure they meet client needs and objectives and do so in a positive manner. Reports are also reflective of performance and an auditor’s understanding of the issue, so a judgment on reports provides the IA Partner an indication of how their team came to the final product. This indicates that IA Partners not only use reports to assess the value to the client, but also to monitor their own team.

The second information cue for IA Partners is the value provided to the client. IA Partners determined the value to the client by assessing if, through providing their resources and supporting management in achieving their objectives, the audit helped improve business performance, gain efficiencies and yield cost savings. Part of their value assessment also included if the client was happy with the audit. Client happiness is considered a key driver for IA Partners in conducting quality audits. When an internal audit is seen as providing value, it is a strong indication the audit was a quality internal

audit. Value and quality are inextricably linked, with an interesting perspective that an audit can be of technically high quality but if it does not create value, or the client is not happy, then the audit is of low quality. The fact that IA Partners see quality as the value for the client and whether the client is happy at the end of the audit, is consistent with findings by McCracken et al. (2008) where external audit partners see their role as keeping the external audit client happy and being an advisor to management rather than a police officer.

IA Partners' judgements of IAF quality appear to be largely driven by a service-orientated and strategic perspective and it is considered that IA Partners judge quality via a strategic lens consistent with a resource dependency perspective. Further, the value perspective of quality suggests that IA Partners view a quality IAF as being a partner to their clients, particularly management, to help achieve management's objectives (Cohen et al., 2008) rather than playing a strong monitoring role. However, IA Partners also consider the audit committee as an important client. IA Partners understand the objectives of the audit committee may require the IAF to have a monitoring role over controls, but also see themselves as a partner to the audit committee to help achieve the audit committee's objectives of risk identification and mitigation. The following quote identifies that while there is an agency perspective of monitoring what has occurred in the organisation, the emphasis is on how the IA Partner really sees the IAF role as being a partner to the business under a resource dependency perspective:

Internal audit, while it does look backwards in terms of what happened, how was the risk managed, how did the control operate – it should be looking forward to where the organisation is going in terms of strategy, in terms of what's around the corner. ... So there is a 'future' piece. (IA Partner)

The strong strategic stakeholder value view and resource dependency perspective held by IA Partners raises a potential issue of IA Partner objectivity. Generally,

outsourced IAF providers are considered more objective (Desai et al., 2011; Glover et al., 2008) because outsourced providers have a portfolio of clients which diversifies their risk, there is less pressure to succumb to management coercion, and outsourced providers also have their firm's reputation to protect (Ahlawat and Lowe, 2004). However, the IA Partners' focus on keeping the client happy and the necessity to provide value may raise issues concerning the IAF's objectivity through economic bonding (Ahlawat and Lowe, 2004).

4.4.5 SUMMARY

While the information cues used by each group have a different focus and emphasis, they are not unrelated. Value is the underlying theme for all groups and permeates the information cues they use to judge IAF quality. ACs use their information cues to gain confidence of quality, then consider the value. SMs are more direct; they consider that if there is value, then this is a quality audit; if there is no value then it cannot be a high quality audit. IA Heads ensure completeness; completeness will mean a quality audit and is likely to create value. The IA Partners take a service approach and if the client is happy and receives value, then the audit is high quality.

Five corporate governance theories have been used to help understand IAF stakeholder perspectives of IAF quality and the information cues used to assess quality. The results suggest three theories can help explain the differences between IAF stakeholders concerning IAF quality: agency, resource dependency, and stewardship. There is evidence to suggest that an AC's perspective of quality and their information cues are driven by both an agency perspective (to monitor management and protection of shareholders) and a resource dependency perspective (the IAF is a resource to the organisation, not only the audit committee). SM and IA Partners motivations appear to be driven from a resource dependency perspective. IA Heads appear to have a

stewardship focus, motivated through identification and attachment with the organisation. There was only minimal evidence within the findings of institutional theory motivating stakeholder judgments of IAF quality. There was no evidence consistent with a managerial hegemony perspective within any group. However, managerial hegemony was important to consider as the IAF plays a role in operational and strategic issues (Beasley et al., 2009; Cohen et al., 2010).

One final implication that emerges from the responses of the two user groups is the potential preference for outsourced versus in-house IAFs. From the results of these participants, SMs may prefer outsourced IAFs as they are more aligned within a resource dependency view. In contrast, ACs may receive more comfort from in-house IAFs acting as strong stewards to help the AC's monitoring role and the protection of shareholder value. This natural tension based on corporate governance theoretical prescriptions adds to the large body of research that investigates the potential benefits of alternate IAF sourcing arrangements (e.g. Desai et al., 2011; Glover et al., 2008; Prawitt et al., 2012; Rittenberg and Covaleski, 2001).

Chapter 5: Findings and Discussion: RQ3

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5.1 INTRODUCTION

RQ2 focused on the main information cues used by IAF stakeholders in judging the quality of the IAF and found that different stakeholders focus on different dimensions (i.e. process, output and outcome dimensions). This chapter presents the findings for RQ3, which investigates what input, process, output and contextual factors are considered by IAF stakeholders as determinants of the quality of an IAF. Each group identified that input, process and output factors are determinants of IAF quality and there are contextual factors which can affect IAF quality.⁴³ The majority of factors were consistent across the four participant groups. Table 8 presents the main determinant factors that were discussed by participants.

⁴³ Although the outcome dimension is considered in the IAF quality framework, outcomes are not a determinant of a quality IAF. Outcomes occur as a result of the IAF and may be used in judgments of IAF quality. Therefore, outcomes are not considered, nor discussed as a determinant of IAF quality in this chapter.

An extensive amount of data was obtained on determinants of a quality IAF. Due to the similarity of the factors raised across participants, this chapter assimilates the findings of the groups and presents the important factors considered determinants of a quality IAF, under their respective dimension from the IAF quality framework. Where one or more groups diverged from the findings reported, this is outlined. The chapter concludes with a discussion comparing the findings to prior literature and the implications of the findings.

Table 8: Identified Determinants of IAF Quality

Dimension	Factors
Inputs (attributes)	Soft skills Technical skills Personality traits (strength of character, inquiring, methodical) Experience (industry and the area of the specific audit) Objectivity
Inputs (structural elements)	IAF reporting lines Use of the IAF as a management training ground
Processes	Strong relationships Auditing with an understanding of the business and audit objectives Audit approach (risk based versus internal compliance based) Effective closeout of the audit engagement
Outputs	Effective communication Relevant and practical findings Relevant and practical recommendations
Contextual	Culture of the organisation Culture towards the IAF Attracting staff

5.2 INPUTS

This section considers factors related to the ‘inputs’ of the IAF that participants identified as determinants of IAF quality. Participants showed strong consensus that a major determinant to IAF quality was the quality of the internal auditors. Participants from each group identified five main attributes of the internal auditor, namely internal auditors’ soft skills, technical skills, personality, experience and objectivity. Participants also discussed structural elements of the IAF as important to IAF input quality. These structural elements included IAF reporting lines and access to the board, and the use of the IAF as a management training ground. First, internal auditor attributes are discussed.

5.2.1 INTERNAL AUDITOR ATTRIBUTES

The following brief quotes indicate the importance of the quality of the internal auditor and hence the internal audit team:

I started by saying it gets down to the quality of people, and it does, if you haven't got quality people you haven't got a quality team. (AC)

The composition of the audit team also has a very big part to play in how well and how efficient it operates. You know, the seniority of the manager you've got controlling the audit team and even the audit team itself. (SM)

I think that for any good quality audit you need to have good quality staff. (IA Head)

People are probably going to be the most significant differentiator. ... The scope and methodology are set, and these are very important and influential to the quality of the audit, but as these are set, the differentiating factor is the people. (IA Partner)

These quotes identify the necessity of having high quality internal auditors. The five attributes viewed by participants as necessary for a high quality internal auditor are presented below. The first two attributes, technical skills and soft skills are discussed together, as interviewees generally discussed these two attributes concurrently.

Skills – Technical skills and soft skills

The skills of the internal auditor are regarded as extremely important to the quality of the internal audit. Internal auditor skills included two components – technical skills and soft skills. Technical skills are seen as the foundation of an internal auditor and their potential to perform quality audits. Soft skills are the next layer – the ability of the auditor to promote the audit to a high quality. The following quotes identify both soft skills and technical skills:

I guess the attributes I'm looking for in an internal audit function are fundamentally the, its tripe, but the quality of their people ... what are their skill sets, what are their communication abilities, how well do they plan and conduct their work? And in relation to that, I'd be particularly focused on do they really understand the business. (AC)

You want people that can bring a range of skills around: knowledge of the industry; good technical auditing skills, you know that goes to things like inquisitive mind, having an ordered logical approach to documentation and evidence retention, and all those sorts of things; knowing how to ask the right questions; and having good interpersonal skills ... and in some cases it might be specific technical competence in a particular area. (IA Partner)

These two quotes are representative of participants' views that both technical and soft skills are important. Participants identified technical skills as important as they are the foundation or base layer needed to begin high quality audits. This is emphasised by the following AC:

Well clearly you have to have some accounting training. I mean they can't do it if they don't know how the bookkeeping works, even with the fanciest packages that you've got... the person obviously has to have the skills, so they need the accounting training. But I think it goes a lot further than that, they need the skills that they can actually appreciate and understand processes. (AC)

Participants noted that most internal auditors had the baseline technical skills, but other skills such as soft skills were harder to come by and often lacking in internal auditors. For example:

[Most internal auditors] their technical expertise in doing an audit in a pure mechanical sense is fine. Where their weaknesses are most likely to lie are going to be in relationship skills, business understanding skills, communication skills. (AC)

You've got to be skeptical and you've got to be professionally engaged but you've got to be able to read people. ... And their [internal auditors'] ability to read people's behaviour isn't as strong as I'd like it to be. And I think that's critical because the art of auditing isn't just around desktop reviews of documents, it's the whole interaction with the business, discussing with the businesses, understanding are they a straight shooter or not, and getting that real good assessment as to the culture. (IA Head)

Again these statements are suggesting that internal audit is about more than simply having the technical skills. In fact, the inference by participants was that soft skills are significantly more important than technical skills, as illustrated in the following excerpts:

Technical skills are important, but they're not enough on their own. An auditor also needs what I call 'softer skills'. This basically comes down to communication in making the customer want the audit. Generally, the internal audit stereotype is that we are introverts and not salesmen; but an auditor needs to sell what we are doing. An audit is rubbish if it is not sold well. (IA Head)

Personal skills and attributes are far more important than any technical skills. Because in theory there is no, you don't do a degree in internal audit, there is no internal audit class; I have not done an internal audit course ... never got a certificate saying 'internal audit – tick'. I am just an accountant. But I think the personal skills are more important. And being able to look at things from a corporate view rather than narrow down, a bit of business acumen. (IA Head)

The baseline has got to be high quality thinking and rigour and experience around understanding of control models and testing thereof. But it has got to be supplemented by communication skills, business skills, and analytic skills. (IA Partner)

Probably more so in the current context than in the past, I think the more successful internal auditors will have better people skills. There's a, if you like, a stereotype around auditors, you know, the brown cardigan that sort of stuff; in my perspective, the auditors that actually provide the real value are the guys that have good people skills, interact well with others in the business. (SM)

A number of soft skills are identified in the above quotes (and were also suggested by other participants). These include analytical skills, the use of logical reasoning, communication skills, business acumen, relationship and personal skills, and negotiation skills. Another soft skill discussed by many participants was the leadership skills of the head of internal audit. For example:

The heads of internal audit departments, the best ones I see these days, and really that means the best internal audit departments as a result; the head has strong leadership and management skills. They have stakeholder management skills. They may not even be trained as an internal auditor or accountant – but they still need to understand risks. Pretty much anyone with high levels of leadership and management skills can run a successful internal audit department. (IA Partner)

Internal audit is about leadership. I think you will find a lot of CAEs are not experienced auditors, they may not be accounting educated, but they are hired as leaders – they have management skills. Part of this leadership is good communication and being business orientated. (IA Head)

These quotes provide complementary evidence to suggest that participants view soft skills as more important than basic technical skills. One reason, for the importance of soft skills over technical skills, as indicated by participants, is that it is quite easy to teach technical skills to someone, expressed in the following sentiment:

You can train people to do internal audit, most people. If you've got the right attitude, you know, a baseline of analytical skills, then you can build internal audit skills around them I believe. You've got to want to do it and you've got to have those base skills, but you can provide that audit framework. (IA Partner)

IAF providers further suggested that when hiring, a differentiator between potential hires is their soft skills as most have the same qualifications. The following IA Head indicated what they look for in a potential internal auditor beyond their technical skills or qualifications:

The second element is the soft skills, the people skills. What we look for in people when we hire is that they have the right negotiation skills, they have the ability to be courageous to say things as they are, rather than

being pushed by very strong powered clients at times. ... We look for people who are ready to challenge the status quo, have good communication skills, and work collaboratively but assertively in a sense that they have to hold themselves to a view if push comes to shove, rather than shying away and dropping off issues. (IA Head)

This IA Head also raises individual objectivity along with soft skills. An IA Partner indicated how important soft skills are when they are hiring an internal auditor, again identifying the prevalent perception that soft skills are more important than technical skills:

What makes a good internal auditor to me when I'm recruiting, I want a person who can engage with somebody, who can have a conversation with somebody and show empathy and not just go 'well I've got a list of questions that I need to ask you', that they are able to actually engage with a client – and that will get the best result for both sides of the equation I think. So they don't necessarily need to be an accountant. ... It comes down more to a personality quite often than a qualification I think. (IA Partner)

While there was this general sentiment towards the greater importance of soft skills, the following IA Partners disclosed the importance of technical skills because they had been involved in audits where they did not use a team with the right technical skill set for the particular audit. As a result, the audit was not considered to be of high quality. That is, audits can go wrong if the proper skill set is not used:

The quality of work that we did in terms of just being able to bring, looking at the right areas; because we didn't have the right competencies or people with the right experience involved, we weren't really looking in the right areas, we weren't asking the right questions; and hence the output wasn't of much value. So it didn't meet the client's expectations. (IA Partner)

We didn't probably bring the right technical competence to bear in the project, and the right skill sets, which meant that we really struggled to get our head around the subject matter. We struggled to meet the client's expectations of what they were after, in terms of they were looking for some insights in a particular process. (IA Partner)

These quotes allude to a technical competence (specialist skills) outside of technical accounting skills. Within the interviews, the main specialist skills proposed by

participants were I.T. and project management skills. I.T. is seen as inherent in every business and every audit; and, as audits in large organisations can be very complex, project management skills are seen as necessary for IAF managers and heads. Participants identified that current audits are very broad and it is imperative to have the right composition of auditors with appropriate skills. Although one problem identified by participants is that the technical skill sets necessary for an audit will differ across different audits. An IA Partner highlights this sentiment:

So depending on what you're auditing, if you are auditing I.T. security, or if you are auditing an operational process like health and safety, those are quite different skill sets. You know, you'll have a good I.T. auditor who wouldn't be able to cut the mustard in a OH&S audit for example. (IA Partner)

A benefit noted by IA Partners and ACs is that outsourced audit firms, such as the Big 4, have greater access to people with diverse skill sets for internal audit projects as they can draw from other teams within their firm. Nevertheless, as noted in the following quote, this can still have consequences. Even though specialist skills are valuable, subject matter experts must still understand internal audit methodologies:

The internal audit process requires a lot of rigour in testing and challenging, and not just accepting what you're told. So, in the review that went wrong, we used people with very strong fraud skills but they didn't have the internal audit skills to actually execute what they were doing. So what we should have done was had internal audit professionals working more closely with those people, to make sure that they documented their findings, that they had actually tested things, rather than just having a conversation with someone, and I think had we have done that we would have avoided the, the blip that came from that. (IA Partner)

Whilst ACs and SMs identified technical skills as part of an internal auditor's attributes, these two groups provide little emphasis as to the importance of technical skills. When technical skills were identified by AC and SM participants, invariably this was simply indicated in an example of high or low quality, with the participant

recognising that the IAF did or did not have the required technical skills. The impression given by the AC and SM participants was that, in the majority, the technical skills of the auditor were a given and the auditor would not have been hired if they did not possess the necessary skills. Contributing to this was the notion that when an IAF did not have the technical skills or subject matter expertise the IAF can source these skills sets externally. Participants discussed the importance of the IAF knowing, and being realistic about, when they do not have the required technical skills to be able to conduct the audit at a high level. This notion is highlighted in the following two quotes:

People need to know when to bring in people with subject matter specialist skills. So knowing their limitations and knowing when to bring in someone with deep industry expertise for example, or a different type of functional expertise. So knowing when to get help is important. (IA Partner)

The area that always causes me a little bit of concern I guess, is what you don't know; so an auditor audits to the level that they know – 'you don't know what you don't know'. So how does a board become comfortable, for example, that some of the emerging risks aren't getting out of control. I'll just pick an example, if you took cloud technology; can an internal audit, audit that control environment and provide the board the assurances, or the audit committee the assurances that there aren't any risks? And I think this is where, you know, a good internal audit knows what they don't know and engages external people in a relevant way, to help them do relevant audits. (AC)

Personality

Participants identified an internal auditor's personality as a crucial attribute of the internal auditor to be able to conduct high quality internal audits. ACs were particularly focused on a strong personality and strength of character of the internal auditor, in particular the head of the IAF, evidenced in the following AC comment:

The internal auditor is always going to at some point put some constraints on what other people do. And you can smile and be polite about it, but the basic fact is people resent it. So you are always going to have an amount of tension no matter how collaborative you are. I mean part of my judgement of an internal auditor is have they got a grounded enough personality to be able to withstand that and live with the tension,

because otherwise they become a rollover; or else they become a complete obstacle to the organisation by really just gumming up the wheels. So you need somebody with a pretty stable, mature personality, to handle what is innately a tense role I think. (AC)

This AC recognises that it is natural for an internal auditor to receive negative tension towards them as their role often involves criticism and suggesting changes to the way people do things. If the internal auditor does not have the character strength to deal with this, it is likely the IAF will be of lower quality, and an impediment to the organisation. This AC went so far as to suggest he/she judges an internal auditor based on their personality/strength of character. Another AC further highlights the importance of the personality attribute, implying that without the strength of character an internal auditor's objectivity and their relationships may be impeded:

Internal and external audit at the end of the day are not fundamentally about just agreeing with management. Irrespective of the findings; there will be occasions when you earn your money by having to stand up and say look I am not satisfied that this is right, whilst giving due process of opportunity for comment and that sort of thing. So I think you need, particularly in the head of internal audit, a strength of character to deal with that sort of thing, because many of us don't like confrontation and having to disagree with someone. (AC)

A number of IAF providers also raised the importance of an internal auditor's strength of character. For example, the following IA Head suggested:

Being able to be not liked at times as well is another aspect that comes with the territory. Sometimes you just have to be able to work through it and be professional in your manner. A lot of the times people do take things personally, you are highlighting things you believe that a particular person or function should do which they are not currently doing; so they take it personally that you are attacking their job, you are attacking the fact that they are not doing these things. But no, it's not about you, it's about the role, it's about the function, it is about actually improving the processes, it is about making sure we are profitable as a long term business at the end of the day. (IA Head)

Another personality trait discussed by many participants as necessary for a quality internal auditor was an inquiring mind. The quotes presented below from participants

from three different groups highlight the importance placed on this personality trait by the different groups:

What leads to a good audit is an inquisitive mind, the ability to keep digging, you've got to keep digging and not leave the process or the person you're auditing unless you are completely convinced and you are satisfied with the answer. (SM)

You have to be able to ask the right questions. You might have findings but you have to be able to ask the right questions in order to get to the heart of the matter, the real issue that you should be able to tell the audit committee ... so what does it mean that? It's not a skill that comes easily and it is not a skill that you can say everyone has got. It's an inquiring mind; it's the ability to get to the root of the matter. (IA Head)

You can't just accept what you are being told on face value, you need to make sure that you look for evidence to support what you're being told. Which sounds sort of untrusting, but you need to make sure that they [internal auditors] are inquisitive enough to find out the full story as opposed to just taking something on face value. (IA Partner)

An AC indicated it is not just the head of the function who needs an inquiring mind, all auditors need to have this personality trait:

To a certain degree [the IAF] is reliant on the people lower down and whether they have capacity to be cynical, skeptical, doubting, whatever the proper description of an audit person ought to be. Whereas the partner, or the head person often can be that way inclined, until you actually get down and dirty you are reliant on the people who are doing the grunt work as I would call it, and then to a large degree as well on the review function performed by the person in charge. (AC)

Participants identified another internal auditor personality trait which they alluded to as 'methodical', highlighting the necessity of someone who will 'dot the I's and cross the T's'. The benefit of an internal auditor with a methodical personality provides comfort to IAF users that important issues in the audit will not be missed. An AC discussed the methodical personality of the head of the IAF at their organisation:

This guy has got the respect, it has taken him a while to earn. ... But he unfortunately has this manner, which really is a quality, you know a methodical, pondering manner that is just ideal for a [profanity removed]

internal auditor. Really, he just doesn't miss anything, he's patient, he is inquisitive. (AC)

This AC identifies being methodical and pondering as 'ideal' qualities of an internal auditor. However, the AC also suggests these qualities cause some annoyance to the audit committee and others when dealing with this person.

A typical problem raised by participants was the difficulty of finding a person with a methodical personality trait who also maintains the other personality traits identified and the soft skills discussed previously. This difficulty was due to the complexity and expectation of the internal audit role – having to be methodical and compliance focused, but trying to assist the business, being practical and maintaining independence and objectivity – requiring a person with a certain personality and character. This is well summed up by an SM:

You have got to be a special kind of personality to be an internal auditor. You to be so highly committed to dotting the I's and crossing the T's. Regardless, you know you've got to be practical but you've also got to stand your ground. And particularly... you want to be assimilating as well ... you're trying to assist that team. It's just really hard to get the right personality. (SM)

Experience

The experience of an internal auditor was identified as an important attribute by the SM, IA Head, and IA Partner groups. The AC group provided very little indication that they view experience as important (whilst none indicate it is not important). Two forms of experience were predominantly discussed: industry experience, and experience in the specific audit area. Participants recognised that low experience levels can lead to low quality audit outcomes whilst greater experience can lead to high quality outcomes.

SM and IA Head participants discussed the importance of having an internal auditor who has spent time, and has experience, in the industry that they are auditing. Participants identified that when the internal auditor did not have this industry

experience, often they were unable to gain respect from management. The explanation is that management perceive that internal auditors without industry experience will not understand the area and therefore the audit will not be valid or worthwhile. As such management will not listen to the IAF, as implied in the following two quotes:

You can't get the respect of the business if someone clearly has no clue, 'well what are you auditing me for you have had no practical experience'. ... So there has to be that respect for the knowledge of the person asking the questions as well. (SM)

You need someone who can sit at the end of the audit or through the audit with the general manager or president of a large operating asset and be seen as a peer almost. Rather than a junior to them where you then get the relationship of 'well why should I listen to what you've got to tell me because you've clearly never got your feet dirty in the coal ... what's your industry experience?'. All of those factors begin to come into play and you want to have the people who can go and say look 'we've looked at this, it's not about my credibility I've been in the business operations myself' and you can have a peer-to-peer conversation around some of the issues that arise out of the audits. (IA Head)

SMs also indicated when an internal auditor can demonstrate a greater understanding of more than just control aspects of the industry, they will gain more respect which will lead to better outcomes of the audit.

The second necessary type of experience is experience in the specific area of the audit. The IA Partner and IA Head participants discussed this facet of experience. Audit area experience provides the auditor with the knowledge and insight to provide valuable outcomes as the auditor is more likely to know where to look and how deep to dig to identify any issues, as commented by an IA Partner:

Experience in the area that they're actually looking at, so an ability to compare. I think the controls, the key controls probably don't change, but you need to have an ability to apply it to the client. ... So an auditor needs to be able to apply what the key controls are to the environment that the client is operating in. (IA Partner)

IA Partners also identified that, exclusive to outsourced firms, having experience with the client is also important.

Participants implied and/or provided insight of the importance of experience compared to other internal auditor attributes, revealing that both soft skills and personality were more important attributes than experience for a quality internal auditor. This sentiment is supported by the following brief statement by an IA Partner regarding hiring an internal auditor:

Maybe they are highly experienced and can demonstrate a level of quality around that, but their communication skills are absolutely poor; I won't employ them. (IA Partner)

Objectivity

The objectivity and independence of an internal auditor was brought up by most participants. Objectivity is seen as an important attribute for IAF quality. Independence was not discussed as important, in fact, too much independence was even suggested as being a negative force on IAF quality. For clarity, internal auditing standards (IIA 2009) suggest individual objectivity is an auditor's unbiased mental attitude and being free from conflicts of interest, and independence is freedom from conditions that may threaten the IAF's ability to audit in an unbiased manner.⁴⁴

The sentiments of participants were that objectivity is very important for an audit to be seen as high quality. Many examples of high and low quality audits revolved around whether the internal auditor(s) remained objective. Below are some examples of

⁴⁴ Whilst internal audit standards interpret independence and objectivity as distinctly different, the IIA contend there is often confusion within practice between the two (IIA 2011a). Many participants, particularly within the user groups, discussed independence and objectivity under the one term of independence. However, in participant discussions it was quite clear when they were referring to individual objectivity or organisational independence. One potential reason for the confusion may be that international external audit standards suggest independence comprises independence of mind and independence in appearance. The external audit interpretation of independence is similar to individual objectivity pronounced in internal auditing standards.

when the internal auditor(s) remained objective and participants considered this as very positive:

The internal audit wasn't critical of anybody, it just focused on here is what is going wrong with the systems, the I.T. isn't robust enough to help make it easy enough for people, and it isn't clear who has got accountability and so on and so forth. Very good diagnostics, and everybody put their hands up and said okay we will try and see if we can make this work better. Now I thought that was very professional work indeed – because it would have been so easy to have sided with one or another, and they steered right down the middle. (AC)

Sometimes it may put a few noses out of joint, but later on they might think about it and say 'oh yeah'. I've had that as well, we've had issues in a particular part of the organisation in [Organisation XYZ], it was with senior management at that time, they have issues with the way you are reporting, what you are reporting etc., but it is all factually based ... so there is tension at that time. But in fact that senior person left recently, and he said to me that we have had difficulties and issues but I have great respect for you. That proves to me that if you do the right thing at the time you are going to have a successful internal audit function. (IA Head)

Alternatively, participants identified audits where internal auditors were not objective and therefore considered the IAF to be of low quality. Two SMs provided recent examples of low quality audits in their organisations due to an auditor's lack of objectivity based on a conflict of interest, where the auditor's relationships with certain auditees became too close, and compromised their judgment and integrity. The SMs both identified that the audits were deemed low quality after the fact, when more information became available.⁴⁵

Many participants outlined the difficulty of an internal auditor remaining objective and still working collaboratively with management. The following two quotes provide support for this notion:

It's very difficult to get effective audit unless you are working collaboratively with management. So internal audit is a lot harder than people think. The methodologies are straightforward; making it work

⁴⁵ Both SM participants requested that the details of their discussion on this matter not be quoted.

effectively is hard. Because we have to be objective, so inherently we need to be objective, but we need to work closely with management to make it work, and that to me is the hardest thing, just how close do you need to be to management to make it work effectively without allowing them to take over the process? To me that goes to the heart of the profession of internal audit. (IA Partner)

So it's an age old issue for auditors and internal auditors, I liken it, as having been a former [external] auditor and having done internal audits I guess over my career, as likening it to sitting on the barbed wire – if you move too far one way it hurts. So in other words, if you move towards management it hurts because the board or the audit committee gives you a hard time; if it goes the other way, management doesn't like you. So it comes down to the independence of the individual and/or the firm. (AC)

In discussing objectivity, participants also raised the importance of integrity of the internal auditor. The following quote illustrates how integrity and objectivity are related:

Integrity is paramount to everything; they [internal auditors] have to be seen as people with integrity, that they won't play favourites, they won't go soft on people, that they will always stand up for what is right – I know there is different versions of what is right – but they need to be seen as to be objective. (IA Head)

ACs were the only group collectively presenting a strong focus on organisational independence. ACs indicated the IAF's reporting relationship, such as their lines of communication and their access to the audit committee were important for IAF independence, for example:

I am very strong on the fact that the internal audit function reports to the Audit Committee via management. Which means that it has the same, that function has the same dilemma that the normal external auditor has, in that the external auditor is paid for by management, and negotiated with fees and whatever, but reports to the Board as an external auditor and a similar situation with the internal audit. So I get, I am certainly particularly strong to make sure that happens. (AC)

Only two SMs and one IA Head outlined the importance of the IAFs organisational independence. The IA Head, discussing factors that may impact IAF quality, suggested:

I am lucky, I have a direct line to the Chairman of the Audit Committee. If you don't have that I think it would be very difficult. I mean you can be lucky, and I have seen it work where people report direct into the finance director or the managing director, so it depends a bit on the individual and it depends on the individual's attitude. (IA Head)

One SM supported this view, outlining their IAF reports directly to the audit committee chair and suggests this is a strong reporting framework. The other SM identified a different aspect of organisational independence, performance incentives, where the objectivity of the auditor may be compromised:

Internal audit, in some ways, need to be independent of management. So if you have internal auditors on the same incentives as a manager for instance, not that [Organisation XYZ] have, but what a bad apple. (SM)

An IA Partner promoted the fact that they were independent would be a source of comfort to the audit committee:

And the fact that we are independent, we don't have an agenda to push, I think is invaluable to them [audit committee]. (IA Partner)

However, there was a large degree of sentiment against the focus on IAF independence, which is highlighted in the following pertinent quotes:

I am less focused on this internal audit being independent perhaps than others. Because you are not actually reporting externally; and by definition an internal auditor is reporting to management. And so I think that is very important for internal audit to be operationally focused, and if that means they are not necessarily as independent as an external auditor should be, then I don't see that presents too much of a problem; other than it might limit the total capacity that the external auditor has to rely on the internal audit work. But in terms of internal audit being in existence to benefit the organisation, well I don't know that independence is that critical. I think the more important issue from that perspective is whether or not the internal auditor and the internal audit group have a good line of sight to somebody who is not necessarily within management if they find something that indicates that the people in management are doing inappropriate things. ... That's not necessarily entirely fool proof because more often than not the internal auditor is still paid by the organisation and they may be concerned about spilling the beans. But ultimately I think that's probably the best way you can deal with making sure the internal auditor has the ability to raise concerns if they feel that management is not properly dealing with those concerns.

... I think that's probably better to be there, to have that as a circuit breaker, then to worry too much about whether or not internal audit is independent. (AC)

The way I see it is that independence is optics, so I report to you so therefore I am deemed as independent. But if I don't report to you, let's say for example you are the CEO and I report to you, then from an optical perspective it may look like I am jeopardising my independence. But because of the methodology I apply, I am able to give you an objective opinion on a particular piece of work ... And that is why you need to have both, it's the optics as well as the methodology, the process you deploy to get to a conclusion. ... Internal auditors are line managers effectively within an organisation, so from an optical perspective you've already lost your independence okay; so you try and get as independent as you can. Therefore you have got a dual reporting to the Audit Committee Chairman which inevitably doesn't work well, and a line manager; and you are an inherent integral part of the company's internal control system. (IA Head)

Internal audit is ultimately part of management and I always have a slight concern with excessive push on the independence piece, because driven to its ultimate endpoint you almost ... you don't want to be seen as purely there for the board. Because one of the risks with that is management then see you as well you're just really there for the board, you're only there to assist the board in meeting its requirements. When you start having that as a filter, that will take internal audit out of a lot of areas that it currently plays in, and it would be much more higher level governance processes, those sorts of things, and you wouldn't be where internal audit actually plays a lot in the operating control space. So I think there is always a risk with this what I call 'pure independence' language that is sometimes used. You need to recognise internal audit is part of management, that's how it gets in and sees things. If it was too far removed it would lose that opportunity. (IA Head)

So the auditors facilitate the scope, that's one of the reasons why audit is not an independent assurance function. (IA Partner)

The implication of these quotes is that there is a fine line between independence and receiving the best outcomes from the IAF through the IAF working closely and having strong relationships with management. These quotes suggest that the greater the push on independence, the more barriers that are created between the IAF and management, which affects the potential quality of the IAF. One IA Head provides a viewpoint that objectivity is important to maintain but independence should be carefully structured:

Objectivity – clearly. Independence – yes, independent of that business unit. But don't drive the independence to the point where it becomes actually a barrier. (IA Head)

Overall, participants were very concerned with the individual objectivity of an auditor, in that the auditor will conduct their responsibilities impartially and with an unbiased attitude, and that they will be seen to be objective by the auditees. AC members were adamant an IAF should have a direct reporting line to themselves, the audit committee, but there was far less discussion on lines of communication provided from the other participant groups. Finally, many participants had an issue with independence, suggesting that independence creates barriers for the IAF that can have negative effects on IAF quality as the IAF needs to work with management and almost be a part of management, they cannot be truly independent.

5.2.2 IAF STRUCTURAL ELEMENTS

There was much less discussion on the structural elements of the IAF as determinants of IAF quality than for the attributes of the internal auditor. Two themes that did appear in the interviews on IAF structural elements are the reporting lines of the IAF and the use of the IAF as a management training ground (MTG). Reporting lines of the IAF (discussed above under objectivity) were identified as important to IAF quality predominantly only by AC participants.

A number of participants identified the practice of using the IAF as a MTG. IAF literature identifies two approaches to an MTG. The first is where the IAF hires internal auditors with the specific purpose of promoting them into management positions in the future. The other approach is where an existing employee is seconded to work in the IAF for a specified time (Messier et al. 2011; Goodwin and Yeo 2001).

Audit committees provided the greatest discussion on this practice and the benefits for IAF quality perceived from using the IAF as a MTG. While a smaller

number of participants from each of the other groups discussed the practice, all participants who identified the practice were supportive of the fact that there was benefit provided to the IAF and as a result increased the quality of the IAF. Perceived increases in IAF quality derives from greater IAF understanding and better relationships with management. Participants also identified benefits to the business, and some negative aspects for the IAF associated with this practice.

ACs identified that the use of the IAF as a MTG provided higher quality internal auditors. Internal auditors gain a broader understanding and more holistic view of the organisation, and become more aware of what might be important to both the audit committee and management. Internal auditors are also exposed to a larger skill base to use in audits which also facilitates their learning. These benefits result in IAFs providing greater insights, indeed:

The types of internal audit environments that treat internal audit as being a part of management, such that people are rotated through internal audit as part of the process of becoming a part of senior management; I think those types of systems generate more authoritative internal auditors and they generate more aware people in senior management. ... So the process of rotating high quality people through internal audit provides [the IAF] with greater capacity to offer true insight. (AC)

Another AC expressed:

Some of the best internal auditors in the world are people who actually rotate into that function out of the rest of the organisation. (AC)

This AC suggested the reason for their perception is because the internal auditor(s) become more aware of what the business requires (a greater business understanding) and what are management's and the audit committee's major concerns.

The collective expertise of the IAF is also improved through using the IAF as a MTG, both in the current period with the seconded manager, but also in the future as the IAF can incorporate their acquired understanding into their existing expertise. The

benefit of utilising the skills and knowledge of seconded managers is a positive step towards IAF quality, as implied in the following AC quote:

Because you constantly get a diversity of skill in that area, which I think is a good thing. You know, you need to have a combination of people with that very good audit mindset and people who have got a very good business understanding; if you are able to combine the two I think you have got almost a perfect internal audit function. (AC)

SMs also support the use of the IAF as a MTG. One SM suggests the practice was more prevalent in the past, however, now with its decreased use in organisations, it is a reason why they are experiencing lower quality audits:

Internal auditors don't necessarily understand the application of that risk management I think to the degree they ought to; and I think that's partly because they have never been steeped in management like they were in the past, so they haven't been through the mill, they haven't seen it, they haven't experienced it. (SM)

Both SMs who discussed the use of the IAF as a MTG indicated that relationships between management and the IAF are improved and that IAF findings are more insightful and relevant. Therefore, the management in the organisation perceive there is greater value derived from the IAF.

A second major benefit of using the IAF as a MTG is improved relationships and support for the IAF. The benefits noted above, namely improved internal auditor understanding and more valuable insights, heighten the support from managers associated with the IAF. Further, managers who have moved into the business from the IAF or a seconded manager returning to the business gain a greater understanding of the IAF and are more likely to be supportive of the IAF. This relation is addressed in the following two quotes:

[Secondment] helps to have management understand what the audit is all about, a wonderful way. If you did that on every audit assignment, I think you would knock over a lot of management – they would begin to understand what audit is all about. (AC)

Maybe they [those seconded] will go out and spread the good word, help to lift the control environment. ... We certainly have built stronger relationships with different aspects of the business. So it helps our networking and we have some advocates out there at different levels. (IA Head)

Participants also identified the benefits to the business and management, for example:

I think it helps them [management] get their mind around the risks and the control environment that they need to be mindful of, particularly as they advance their careers. (AC)

They were internal audit, but the team was really about training people in management and getting process improvements in various projects that they were put on, which lead to improvements, or improvement enhancements if you like, within the business. (SM)

Participants speculated that these business improvements are likely to endear management to the IAF. Therefore, again improving relationships with, and support for, the IAF.

Participants did identify that there are potential negatives of using the IAF as a MTG. For instance, the IAF can lose some of their best internal auditors, which affects their ability to perform high quality audits. The following AC and IA Partner comment on this issue:

The downside to that is, is often you end up with a diluted internal audit department, or not necessarily particularly strong, because as soon as somebody demonstrates that they are really good they often get whipped out of internal audit and into other roles. But that is still a model that I think works well and works effectively. (AC)

People with commercial nous often get snapped up in the business. And so having audit as one of the avenues where people within the business can access talent is great, but that presents challenges for the audit function. In some cases, you're losing all your really top performers out to the business. There is good and bad aspects to that. ... Generally you have a better performing function, you deliver better results and that sort of stuff. (IA Partner)

In contrast, one IA Head suggested that an internal auditor being taken out of the IAF and into the business was a measure of IAF success:

We bring people into the company, they spend a few years with [the IAF] and it's a great steppingstone into roles within the business. So one of our measures of success is how many of our people have moved out of internal audit into business line roles. (IA Head)

Another negative to this practice was that secondment can impact the productivity of the IAF. An IA Head discusses this problem for their firm:

I would have to say we find it very draining on our internal audit resources, being a small team trying to accommodate someone with no audit experience in an area they have never audited before, because they have to be independent. And then trying to impart the disciplines you need for auditing... And we found that if we do too many of those, then we can't achieve the audit plan. It really does impact our productivity. (IA Head)

Despite these negatives when using the IAF as a MTG, overall support for this practice was very positive and seen as enhancing IAF quality, or improving determinants of IAF quality such as strong relationships. AC and IA Head participants were more supportive of an MTG via secondments of existing staff members. SMs recognised benefits to both MTG approaches, as the approach of hiring an internal auditor with intention to move them into the business provides management with a greater pool of talented candidates who have proved themselves in the business. While it is obviously difficult for an outsourced IAF to implement this practice, one IA Partner did suggest the benefits are so strong that they often recommend it to companies with whom they co-source the IAF.

5.2.3 INPUT SUMMARY

Participants identified five attributes of an internal auditor that are important to IAF quality. The first attribute is an internal auditor's technical skills, considered to be the base layer for a quality internal auditor. The second attribute is an internal auditor's

soft skills, and these soft skills are often what differentiates the high quality auditors from others. The third attribute is an internal auditor's personality of which important elements are their strength of character, an inquisitive mind and a methodical mindset. The fourth attribute, raised by IAF providers and SMs, is the experience of the auditor within the industry and the specific area under audit. The fifth attribute is an internal auditor's objectivity that is seen as paramount to IAF quality, however not pure independence as independence can actually hinder quality.

One structural element of the IAF was discussed by all four group as enhancing IAF quality, which is using the IAF as a MTG. A second structural element, the IAF's lines of communication, was identified as important to IAF quality by AC participants.

5.3 PROCESSES

This section considers four consistent themes related to 'process' factors emerging from the interviews that were viewed as determinants of high IAF quality. The four themes are: building and maintaining strong relationships; an internal auditor's understanding of the business and audit objectives; the type of audit approach used, such as risk-based audit or an internal compliance 'tick-and-flick' audit; and the closeout of the audit engagement.

The first theme is an auditor's ability to build and maintain strong relationships with management and auditees. Building and maintaining strong relationships is seen by participants as an imperative to high quality IAFs. Strong working relationships develop trust, respect and confidence in the IAF, which are viewed as crucial in order to extract information from auditees, understand the business and audit area, and provide the best results for the business. Without strong relationships, participants perceive great difficulty for the IAF to conduct high quality audits as there will be a lack of support from management or the auditee, and it will be difficult to align with management on

audit objectives. An IA Head provided an example of the difficulties created when strong relationships did not exist:

If internal auditor's relationships aren't strong it would be very difficult for stakeholders to accept internal audit reports, there would be strong doubt on the quality of the audit. This was the case with my predecessor. He was a highly skilled auditor but he got on the wrong side of people. People put up walls. It is very hard for the audit committee to see quality audits being conducted when relationships are poor. (IA Head)

The following IA Partner quote exemplifies how easily the quality of the internal audit can deteriorate when a basic relationship is not established:

There was no underpinning relationship, the trust wasn't there, the questioning wasn't there. The organisation had an expectation that they were going to get this particular service, and the guys that went into that team believed that they were doing something completely different. And it went pear shaped very very quickly. (IA Partner)

Similarly, the following AC quote depicts how poor working relationships between the IAF and management will affect the value created and the perception of IAF quality:

[A] big issue is the ability of the actual auditors themselves to interact constructively and non-confrontationally with the team. So you can be firm in your finding, but it's how the message is delivered to the team because I think that will make a big difference in terms of the level of engagement and interaction. So if there's hints of ... a confrontationist approach I think the value of the audit is completely watered down. And I think that's primarily because management will say well they [the IAF] don't understand, or they don't understand the business, or they're not actually adding value to the business. ... Once people get their back up, the value of the process drops away really quickly. Whereas if there is good quality, constructive, robust engagement and I think everyone gets the maximum benefit. (AC)

SMs see relationships as a key focal point of a quality internal audit. SMs' discussions indicated that poor relationships create tension, which then leads to management and auditees becoming defensive or uncooperative. For example, an SM commented:

I see myself as a customer not a victim; but the badly managed internal audit function can create a 'them and us' situation very easily. I would

prefer to see myself as a customer and therefore on the same side of the table as the internal auditor, rather than being interviewed by a policeman. And I think there is a certain amount of defensiveness that can automatically come into the relationship if that approach is taken. (SM)

The same SM indicated that not only is it the responsibility of the IAF to develop good working relationships, but also the responsibility of management. This was a consistent view mentioned by SMs. The following quote illustrates how SMs typically attempt to achieve their part of the shared responsibility:

I try and work with auditors, whether they are internal or external, on a very open basis. So that means at the beginning of every audit we sit down and we talk about the aims of the audit. That enables me to be as open, and to make it as easy as possible for the audit staff to actually complete their engagement. (SM)

Many participants discussed a specific aspect of building relationships; this aspect is the onus of internal auditors to get more involved in the business and talk with people working in the business. When an internal auditor does this well, relationships are perceived to be improved. Other benefits indicated were that it increases the ability of the audit to be of higher quality as the auditor will likely receive ideas to follow up by people in the business, and gain a better understanding of the objectives and needs of the business. For example, the following IA Partner indicated that by talking to people in the business the auditor should get information from auditees:

I think the majority of reviews we do, it would be very rare for us to uncover something that the client didn't already know about. And I have this conversation with our auditors all the time, that if you talk to the right people and you listen to what they have to say, you'll generally extract all the issues. And then it is your role as an internal auditor to listen to that issue and take it away and verify whether it is actually an issue or not, by sort of reviewing evidence or whatever. So I think that is the key. (IA Partner)

This IA Partner also indicated that strong relationships and trust must be established to have people be forthcoming with information. Similarly, ACs were intent on having the

IAF be amongst the business as it fosters stronger relationships and develops the internal auditors' understanding of the audit area, as implied by the following comment:

I really encourage the internal auditor to get amongst the business. Internal audit doesn't work if they simply sit in an office and go through the motions. They need to get amongst the organisation and its people, develop relationships with these people and they have to be comfortable with you. I found the same when I was an external auditor; you learn and pick up things from talking to people. You might talk to a person who tells you they have been working on reconciliations for over a year and it never gets worked out or improved. This is good information; it helps you in making an assessment of the area. If you simply sit in a room with the Department Head, he can tell you anything and it's the only view you have. You have to get out, get your hands dirty, talk to people. Talking to people gives you ideas. Then you need to go and look at the details and see if those ideas are supported. So I really encourage internal auditors' to get out there. (AC)

Strong relationships also give the AC confidence in the IAF:

In one of the firms I was on the audit committee, a payment manager went on leave, now this manager provided his password to his staff who were then able to conduct transfers of up to \$20 million. One of the staff, who obviously thought this was wrong, called internal audit with their concern with what the manager had done. Now by this staff member calling internal audit, it showed me that the Head of internal audit had developed a rapport, developed trust and confidence that someone would call him about an area [internal audit] were not reviewing at the time, and this gave me a lot of confidence in the internal audit. (AC)

Relationship quality and IAF quality is further built on up-front engagement by the auditors. For example, an IA Head indicated:

So in particular a formula for success ... is heavy front end communication, engagement and planning; it often then results in good feedback, appreciation from the business or the client or whatever you want to refer to them as – the auditee. Where that hasn't occurred, that can often lead to issues and audits that don't go as smoothly; there's more tension, there's debate about why you are here, what is the scope, 'I didn't realise you were going to look at that', management maybe not all on board and available when audit want them to be available, data is not provided in a timely basis. (IA Head)

Up-front engagement was also indicated by an IA Partner to be important to understand the needs of the client because it could be the difference between the client's perception on whether the audit was of high or low quality:

One of the things we try and do now is actually define, so when we do audits, is say to the people, the sponsors, 'what do you see as value from this project? So to you, what would be valuable?' You can have clients say, 'well I just want comfort; I think everything is working well in this area, I don't expect you to find anything but I want you to go and check it and give me that assurance'; you know that is the typical sort of assurance/compliance. So if you come back and say 'well actually everything is working fine, we haven't found anything, there's nothing to report'; one view of that would be 'well that's not giving me any value, you haven't found anything'. Another view of that would be 'fantastic, that gives me a lot of comfort, I can now go to bed and sleep at night, because I wasn't sure, and now...' So it is important to define that up-front; because you know, there is the same work, same report, and you could have two complete different views of the output. (IA Partner)

As identified in this discussion on relationships as a process factor of IAF quality, stronger relationships can provide the IAF with valuable information and a greater understanding to conduct the audit which should lead to better quality outcomes. The second major theme under the process determinant of IAF quality is an internal auditor's understanding. Understanding revolved around two key aspects: firstly, an internal auditor's understanding of the business and the objectives of the business; and secondly, an internal auditor's understanding of the bigger picture or objective of the audit. Combined, these two aspects of understanding are regarded by participants as extremely necessary to conduct high quality internal audits.

The internal auditor's understanding of the business, the business' objectives, the environment and the issues the entity is facing, is seen as important by all four groups of participants, but particularly by IA Partners and those who employ outsourced providers; in-house IAFs were presumed to have a slightly better understanding of the business. Without an understanding of the business, it is very difficult for the IAF to

align their audit strategy with the business strategy to achieve the best possible outcomes. An IA Partner noted:

I always say to my teams how can you audit something if you can't understand it? If my gang doesn't understand their clients or their business models etc., how can you possibly audit it? I think that is probably one of the root causes of poor reports that I have seen. (IA Partner)

Another IA Partner emphasised the importance of understanding the objectives of the business:

Internal audit can't operate in a vacuum. The work has to be done in context of where the organisation is moving and heading, and so making sure that the audit itself is working in alignment with the corporate strategy. So, for example, if an organisation has a strategy that is based on significant growth, the audit focus should be on saying okay what processes do we need to have in place to facilitate that growth. (IA Partner)

This IA Partner indicates the necessity of understanding the business to be able to align the audit and recommendations from the audit to help give a positive and valuable outcome. The following IA Partner indicates how the IAF can be a negative force when internal auditors do not have an understanding of business objectives:

There is a lot of power that goes with an internal auditor. You wouldn't think so sometimes but, it has power to consume the resources of the organisation. If we raised recommendations that aren't aligned with the direction of the organisation, we are actually going to be a negative force in that we are actually going to distract, divert resources from working towards that objective to doing other things. ... And that's actually quite common in internal audit functions, you see them focusing on things which are not the corporate goals. ... So that alignment is a key to the quality. (IA Partner)

A common concern cited by SM and AC participants is that an IAF often have a narrow view when they find an issue and do not understand how best to fix the issue from a business perspective. Most often, the IAF will recommend that more controls are

necessary although this may not be best for the business. One AC described a typical scenario:

Often the type of debate I've seen between internal audit and management has been around the discovery of a problem; and under those scenarios the internal audit response is 'well let's put in more controls'. Then management will fight back and suggest it's either impractical or unrealistic or whatever else to put in all those extra controls. So a one-off problem isn't fixed by throwing a whole pile of additional bureaucratic structure around it. (AC)

This quote reveals that often the IAF does not look at the bigger picture, of what will be best for the business, and they focus at the lower level control environment. Participants indicated a regular problem with internal auditors is their focus is very limited and they do not look beyond the specifics of the audit. This occurs when the auditor does not understand the 'big picture' and therefore does not perform the audit with the bigger picture in mind. This notion of an internal auditor's understanding of the bigger picture is the second aspect of 'understanding'. Participants identified that, necessary for a high quality audit, auditors (particularly less senior auditors) need to have an understanding of what the objective of the audit is, and to think outside the square. A few salient quotes illustrate this idea:

One thing that I've noticed, it comes down to the execution of audits in a quality sense is, the danger of doing an upfront test plan to execute an audit where team members get too focused on what is written on a test plan sometimes, and they don't think beyond the box, and outside the questions that are in front of them to see have I managed the risk or if I've looked at the risk of what I'm trying to cover. ... And if the team members are not questioning beyond what is written on a test plan, then they might miss the opportunity to identify issues that's hidden in the detail. (IA Head)

Things that sort of frustrate me about the team from time to time, is that they can be so focused on the scope of the review that they forget about the big picture, and what an issue might represent in terms of the bigger picture. Or whether they will come across an issue that may not be necessarily be technically part of the scope of a review but is of such significance that it ought to be reported in any case. So I think auditing with the blinkers on is sort of an issue. And again, that comes back to I

guess, having some understanding of the broader organisation, but also the understanding of just the implication of issues I think and linking it to what is the risk of that issue. I mean it is the whole ‘so what’ sort of thinking. (IA Partner)

I think there is also a need to have an understanding of shades of grey; in that there can be the policy and there can be what the organisation is doing, and it still mightn’t be the right thing because the policy mightn’t be the right thing. ... Where internal auditors are coming back and saying ‘oh somebody didn't follow the policy’, it's like, well tell me if the policy is right to start with – that's what I want to know. Don't just say they didn't follow the policy to the letter of the law, as a policy might be fundamentally flawed or out-dated, or processes or technology might have moved on since then. (IA Partner)

These quotes all identify that without a bigger picture understanding, many important issues may not be picked up or may even be dismissed, or the IAF will fail to question the systemic issues. An AC provided an example of an audit that did not look toward the bigger picture and therefore missed significant issues from the audit, which were far more important to the audit committee and the business:

Internal audit got involved, but they probably burrowed into the detail, they looked at what the laid down processes for initially recording claims were and setting assessments and whether that had been followed. And there were far more significant issues in terms of the adequacy of the people doing that process, whether the assumptions they were using were appropriate – they hadn't been reviewed for some years and the environment had changed materially, so they were quite out of date. And this ended up leading to quite a material understatement of the reserves. But the internal audit, by focusing more on was there a signature on a page that recorded the claim within two days of it being received, sort of missed the bigger picture issue which came out a little later. And probably by not standing back and saying ‘well what are the key things that could go wrong here, what are we actually looking for?’ they missed the significant issues. (AC)

A lack of understanding of the bigger picture was often related to the reason why an audit was considered low quality, and particularly the cause of a lack of respect from executive and departmental management. This relation is addressed by the following IA Head comment:

Where you lose credit [is] when the auditors get too focused on their issue rather than stepping back and recognising, well put yourself in the shoes of the line management person, all the things they've got to do in their normal day, and just put this in the hierarchy of what's important – what is the real risk here? As distinct from there was a tick required in this box – what's the real risk around this? (IA Head)

This IA Head indicates that an internal auditor must understand what the big issues are for the business, and take a big picture view, not an internal compliance type audit. A SM also addressed this issue noting that it is rare to find internal auditors who will go past a 'tick-and-flick' audit and look at the big picture:

It is very rare in my experience to work with internal auditors who have a very big picture view of the business and the way the business needs to operate or should operate. It is very easy for internal auditors to take, to have, to own a very small view of the business; and it is very easy for them to retire back into that very small view of the business and concentrate on, you know, internal controls and all of that ticking and flicking. And that is not where, I understand that that has to be done, but I don't believe that is where value is actually created. (SM)

These previous two quotes identify the approach of the audit is affected by an auditor's understanding of the bigger picture.

The third theme to emerge in the interviews about quality IAF processes is the process approach of the IAF, such as a focus on either a compliance based 'tick-and-flick' audit or a risk-based approach. All four groups discussed the IAF approach, but in-depth discussion was particularly predominant from ACs and SMs, the users of the IAF service. Many participants referred to the quality of the audit being affected by the type of approach the IAF took towards an audit. Evident in the previous quote by an SM, participants do understand that compliance based 'tick-and-flick' audits are necessary; however, this sole audit approach is viewed as being a lower quality audit as little value is achieved from this approach. The consensus was that the business needs to understand from the IAF why the problem is occurring, not simply that there is a problem, and how the problem relates to the risks of the business. Overall, when a

problem is identified and it is a risk to the organisation, is when participants see the IAF as being of greater quality and providing greater value. For example, the following AC indicated:

Again, the better ones that I've seen would use a risk-based approach. ... What sort of risks they are doing, whether they are trying to deal with risks or whether or not they are trying to audit areas they think are more risky. So again I think they are far more useful, provide probably greater value to the organisation than the ones that are just, again, ticking and flicking to try and confirm that something that should be happening is in fact happening. (AC)

Another AC supported this:

There's a lot of audits which I look at that, you know, it's the sort of tick-and-flick mentality. It's not really auditing a risk issue, whether it's a control issue or even a systemic risk ... it's more sort of a procedural compliance tick-and-flick audit. And I just think a lot of those of very low value. It sometimes can take up a lot of, a lot of time; and at the end of it I'm not quite sure if you are better off or not. (AC)

However, one AC presented a contrary view on the value of 'tick-and-flick' audits. This AC perceived that there is some value in knowing about internal compliance; however, he/she found it hard to perceive they were high quality audits:

A poor quality internal audit is the one that is just sort of running around doing ticking and flicking ... more in the nature of compliance – whether or not people are complying with rules and regulations. You know, that is valuable work but whether or not it's work that you could point to an observe that it is good quality internal audit is hard for me to accept. (AC)

Participants did not view the IAF approach of a procedural 'tick-and-flick' audit as an issue within the planning and scoping of the audit. Many of the stakeholders including the audit committee, management, internal audit and occasionally external audit together work out the audit plan and scope. The issue with the 'tick-and-flick' type audit was generally conceived to be a fault of the internal auditor, often due to their lack of understanding of the objectives of the audit and how best to audit for business value.

For instance, an IA Head indicates it is often the problem of the IAF not understanding how to perform a quality audit:

Some of the companies are still stuck in the tick-and-flick, looking at the financials more rather than the operational effectiveness, efficiencies. So if the internal auditors themselves don't really know what it is that a quality internal audit function should be doing, then how can the board? (IA Head)

This quote emphasizes that often this problem is caused due to the scope employed by internal auditors. However, one AC did indicate that they thought the cause of this audit approach was due to the scoping set by someone influential on the board:

Some of the lesser quality internal audits I've seen have been ones that are little more than ticking and flicking exercises. I don't think that that really adds a lot of value to anyone and typically the primary reason for those types of audits is some, it is often to do with someone thinking if they actually did the ticking and flicking inside the organisation they might save on the external audit fee. (AC)

Interestingly, an AC stated there are still problems when a risk-based approach is undertaken by the IAF, and that this approach will not always be of high quality or value:

You know one of the weaknesses of internal auditors ... a common weakness with them, is they focus on the easy risks, the obvious risks, and the ones that are probably best controlled. And they don't always focus that well on the risks that are not well controlled, are less obvious, and are the ones that are likely to get you into trouble. (AC)

Again, this last quote reveals a link between the audit approach and whether the internal auditor understands the bigger picture.

The fourth process factor theme was the closeout of an audit engagement. The closeout is concerned with how the IAF and management deal with IAF findings before they are reported. Participants indicated that management need to be given the opportunity to review audit findings. This important stage of talking through the findings and having management correspondence and insight delivers the best outcome

for both groups, and will influence the quality of the report, management's reactions and action upon the report.

ACs indicated they thought this was an important process, largely associated with the fact that their time and audit committee meeting time is valuable. Therefore, ACs do not want IAF findings discussed for the first time at the audit committee meeting and having management refute these findings, as this wastes time when they could have been discussed and sorted out prior. Further, when this closeout process between the IAF and management has been conducted, ACs perceive this as an indication that any findings presented to the audit committee are significant and that management agree, therefore there is an imperative for action on these findings. The other three groups (SM, IA Head, IA Partner) see the closeout as important because it gives management the opportunity to check internal audits' facts, discuss the implication of the findings, provide or receive an alternate view, and promote a basis to create solutions.

SMs were of the consensus that they have the opportunity to view the findings and a draft of the report before it is finalised, arguing this opportunity will add quality to the report. It also gives management the ability to respond to the IAF's findings and is an area where they develop or confirm their perception of IAF quality as they can determine the extent of the IAF's understanding. The IAF's cooperation in providing management this opportunity to discuss findings and the manner the IAF raise their findings also contributes to management's view of relationship quality. One SM highlighted the importance of this procedure:

Because we need to be on the same page and it's not that they're just going and reporting things, but absolutely that we've also considered it and discussed it with them and we've got an agreed approach for going forward. And even the issues that we are raising that we are agreeing, that yes those are the issues we should be raising. (SM)

Another SM offered a similar perspective on the importance of this procedure, however, they indicated the IAF was not always cooperative regarding the opportunity:

And then at the end of the audit I basically require an exit meeting – it is very simple stuff but it works very well – where we go through basically the findings, the draft findings of the audit, and it gives me and my team an opportunity to correct any misunderstandings. And then following that, I like to see a draft of the audit report before it goes to the Audit Committee. In some instances that has been a very difficult process to gain cooperation from, especially internal auditors; external auditors I find that usually quite a simple approach and it works well, but in some internal audit cases I have found that level of openness and communication to be difficult to create. (SM)

Many IA Heads revealed they conduct this procedure with management because it leads to better buy-in for action on findings and recommendations, promotes stronger relationships therefore making future engagements easier, and is seen as being of higher quality by the audit committee. IA Heads also want to provide the right answer for the business, so this process gives management the opportunity to point out something the IAF may have incorrectly identified or not included in their assessment. The following IA Head provides a typical description why IAs considered the closeout important:

We all want to get it right answer in the end. ... We don't issue the report until management have signed off that they've, they're comfortable with what is in there. So it is not a kind of here it is, no correspondence entered into a situation, because that doesn't work in the end. If you want to get buy-on to the actions, it becomes then an argument that 'well I didn't agree with that finding'. This is 'yes, management accepts the findings', sometimes as uncomfortable as they might be. (IA Head)

IA Partners highlighted how this process can affect perceptions of quality, as it will influence how management perceive the quality of the audit, their respect and confidence in the IAF, and their level of agreement and therefore the likelihood they will accept the findings and take action on them. A sentiment raised by IA Partners is that a difficult issue for internal audit is when management disagrees with findings in the final report. An IA Partner discussed the closeout:

The closeout of an audit will be with the people responsible for the area being audited first, because they need an opportunity to check the auditor's understanding. The auditor might have only been in there for a week or two weeks and they have been running the business for a couple of years say. So you need to check your facts and your understanding and the implications. And sometimes coming out of that someone will say 'yes I understand you found that but the way I manage that risk, or the way I look at it, is like this', and give you another perspective that if you go away and check that, you've got further information. So that piece is very important. It is also important to manage though, in that, since they're the people that are being evaluated that that's a robust process. ... So one of the biggest challenges in the role is actually that level of closeout because those people, how they feel, the feedback reflects on them personally. (IA Partner)

This IA Partner indicated that whilst it is a very important procedure to get the best outcome from the audit, there can be some difficulty involved and the objectivity of the auditor must be resilient. This quote also alludes to the service focus many IA Partners have. Another IA Partner discussed how their firm conducts the closeout with a large client and the result of the client perceiving they have received a high quality audit:

Rather than going to a closing meeting with your agenda or your few dot points and you verbally discuss it and the client then goes 'yeah, yeah, I see what you are saying', then they get the draft report a week or two later and go 'no way!'. What we do is we issue a flash report no later than 24 hours prior to the closing meeting; it sets out each of the findings, the criteria, the condition noted, the consequences, the recommendation - but it is not rated. So then we use the closing meeting to align on the facts, and, because we haven't presupposed the rating, we align with the client on is that a low, moderate, high sort of issue. Then we use the meeting as a solutions workshop to say okay how are we going to address this? Just through that process we are getting this massively positive feedback from the auditees within [Organisation XYZ] saying this is a really good process that they have bought into ... the feedback has been that they have received high quality out of that internal audit. (IA Partner)

Overall, the closeout of the audit was seen by participants as a very important procedure in the audit process. The procedure affects relationships between the IAF and management, management's acceptance of the findings and the IAF in general, and it

increases the likelihood that only important issues are raised to the audit committee and senior executives.

From a methodological process point of view, there was less discussion from participants, particularly by AC members. SM, IA Head and IA Partner participants raised a few factors they regarded important to quality IAF processes. These methodological factors included the necessity of using analytical tools such as Data Analytics; procedural guidance to follow, such as the COSO process which was suggested to make an IAF look at the audit more holistically, both at a high level and a more detailed level; and the sampling sizes used by the IAF. An IA Partner summarised the important elements of the IAF process:

It starts with an understanding of risk that relates to the area that's going to be audited, and then an agreement of scope that we believe is going to address that risk. Then it's about, against that scope, executing the steps that are implied by that scope, summarising it all, pulling it together, reporting, concluding, and then also a piece of stepping back over a number of audits and looking at trends and things like that. So I'd say there's a fairly, that is a fairly common process if you like at a high level, but the subject matter makes them seem quite different at a specific level. But the steps I think a fairly standard. (IA Partner)

This quote provides insight to the potential reason why there was little discussion on the methodological process of the audit. This IA Partner reveals that most audits have a common methodology that does not change much over various audits. Potentially, participants accept the methodological structure is consistent, and therefore would only affect IAF process quality if the method is not followed.

The findings of this thesis have generally presented common themes proposed by participants. However, it is important at this stage to reflect on what was not discussed as a determinant to IAF quality within the process dimension. Adherence to prescribed standards is a factor of the process dimension (Sutton, 1993). The IIA considers a high quality audit as an audit that conforms to IIA standards and one that meets stakeholder

needs. There was minimal discussion on internal auditing standards. Overall, only one participant, an IA Head, discussed internal auditing standards and their relation to IAF quality. This IA Head suggested that following, and compliance with, IIA standards is a key to IAF quality and his/her first IAF quality measure. Only four other participants, all IAF providers, mentioned IIA standards. Two IA Heads indicated that they do conform to IIA standards as is indicated under their internal audit charters. Two other providers, one IA Head and one IA Partner, discussed that compliance with standards could be considered by some as a measure of quality. Both suggested however, that viewing quality as compliance with standards is a simple view as there is much more to quality, such as the 'value-add'. No AC or SM participant mentioned internal auditing standards in any part of their interview.

In summary, within the process dimension, participants identified four key themes as determinants of the quality of an IAF. First, is the auditors' ability to develop and maintain strong relationships, and be a part of the business. Second is an internal auditor's understanding, which includes aspects related to the understanding of the business and the business' objectives and an understanding of internal audits' objectives (the bigger picture). Third, is the type of audit approach used, and whether the audit was an internal compliance 'tick-and-flick' type approach or a risk-based approach. Fourth, is the closeout procedure of the audit engagement.

5.4 OUTPUTS

This section considers internal audit reports ('reports') which were strongly identified by participants as the most important determinant of IAF quality within the 'output' dimension. Two central themes emerged as significant to IAF report quality, namely: characteristics of effective communication; and the relevance, quality and pragmatism of findings and recommendations raised in the reports.

The importance of reports to IAF quality was enunciated by each participant. Reports are an IAFs key deliverable: this is how an IAF delivers their message and this is the end product. Consider the following few brief quotes:

At the end of the day if you can't communicate it, it doesn't matter what you've done because no one knows and is not useful except to your own self. (AC)

If I don't know what the report is telling me, what you are telling me, or there is not enough information there, I can't do anything with it. (SM)

We have reflected a lot lately that the whole audit counts for nothing if you can't deliver the message at the end; so how important that [the report] is to have impact. (IA Head)

As is evident from these quotes, an IAF could have optimal inputs and processes and even perform a technically perfect quality audit, but if it is not communicated effectively in the report, the audit is of limited use to the recipient of that report. For this reason, many interviewees articulated that reporting quality was a critical step in the audit and one that strongly affected the stakeholder's perception of IAF quality.

A large portion of discussion on reports by most participants was negative in nature. While not all reports were seen negatively, it appeared that for participants to compose their viewpoint it was easier to be descriptive by reflecting on, and discussing, negative aspects of reports/reporting.

The first theme of report quality is the characteristics of effective communication. A large number of different characteristics of the report were discussed by multiple participants. ACs were particularly concerned with the report's ability to communicate the important message. For example, the following AC indicates that a problem he/she has with reports is that the reports do not give the audit committee an indication of the importance of the issue:

This is probably the area where I have the greatest source of frustration – just woeful, woeful reports. They either say absolutely nothing, like a whole lot of jargon of repetitive boilerplate as I'd call it, of the process and a small paragraph at the end saying no exceptions found, or no material exceptions found, or three material exceptions found noted in the appendix and whatever. So you're left with this sort of sense of I don't know what you're telling me. And to be honest that's probably my biggest reaction: I don't know what you're telling me. I don't know whether I care about this or not. (AC)

Similarly, other AC members indicated they often have trouble understanding the report, including how the audit issue, and the implications, fits in the big picture for the company. For example:

The other thing that I find often with the reports is they don't look at the systemic issues, again they do discrete audits, and I always say 'well stand back from all of this, look across the branches, tell me systemically does this tell you anything about the organisation, its culture, its structure, its control environment, its management? Is there something here that we can draw some dots around to say that maybe there is a bigger issue we need to be exploring, or a more fundamental one?' And again I don't see that often happening. So the reports are either made meaningless to make them non-contentious so they can get them issued and not have a big fight, because that's the other big issue. Or they're meaningless because they can't communicate. Or they're meaningless because they become very task and transactional rather than standing back and really saying okay what does this all mean. (AC)

If I went back and looked at all the internal audit reports I've seen, the ones I would tell you were the most valuable were the ones that had the best reporting. And for me, that's about pictorial reporting. ... I've been quite intrigued over the last six years how many reports are done at the Board level, whether it be internal audit or not, that are what I call absolute reporting. So they are not relative reporting, so they are just absolute layouts of information. And as a Board member you need relativity, you need relative reporting, you need either reporting against other companies, you need reporting against yourself over time ... I need to see relative reporting, so I know what to do, I need to go past the 'so what'. If you see an absolute report you get the so what; so what – what does that tell me? (AC)

IAF providers suggested one way they can help the recipient of the report understand the full consequence of the issue is to align the audit strongly with

organisational risks and report the audit issue in alignment with those risks. For example, one IA Head suggested:

Putting it [the finding] in the language of risk. So why are we doing this? We're doing this to mitigate a risk, rather than because it is some kind of good practice that nobody understands or the auditor thinks is a good idea; making sure it's anchored to something that people can relate to. (IA Head)

Providers of internal audit were cognisant of the fact that they are producing reports with the aim of changing behaviour or processes within the organisation. Seeing themselves as 'change-agents', the providers discussed how important the way their message is delivered is to the extent a report will be acted upon:

If you can't land the actions coming out of the audit, then again the audit has been for nothing. So that very last step of how you get sustainable change coming out of a piece of audit work is the context in which you make your recommendations is critical. ... So it's closing the loop; and the report is the critical part for all of that – for educating, for winning hearts and minds, and for getting traction on actions. (IA Head)

IA Partners also had a similar view, that reports cannot be too negative:

Bearing in mind that you are, if you are at your most effective you are going to be a change agent, you are going to try and actually persuade people to do things better, to improve controls and those types of things right. If you go into your own personal psyche and say well how did anyone ever influence me to change something – certainly not by hitting me across the chops with a litany of crimes and a fix-it note. It was about acknowledging what you did well, considering what might be done better and/or trying to helpfully frame a solution that's fairly pragmatic. And that makes a big difference I think to a good report and a bad report. So some reports we see are horrendous insofar as they are like confrontational to the extreme almost, and you have to say to yourself 'gee, why would you write it that way?', the recipient of that report would have just switched off. ... Because, let's face it, nobody likes receiving communications like that. So style is very important. (IA Partner)

See if you report just by exception clearly it is a negative piece straight by its very nature. I think the other piece that we definitely try to follow is "you catch more flies with honey than vinegar" as they say. So it is really important for the writer of that report to actually imagine what is

the recipient going to feel like when that is put down in front of them and they read it. (IA Partner)

These quotes suggest that internal audit providers certainly realise that in order to change and persuade recipients of the report, there is necessity to provide balance within their reports, to deliver hard messages in a positive and non-confrontational way, and in a way that the reader sees that the change will benefit the business.

Users, the recipients of the reports, often discussed how important it is for a report to indicate the key message and recommendations, and not be hidden within a lot of other detail. For example, an SM discussed how he/she changed the style of IAF reporting at their firm:

One of the things that used to irritate me was that an audit report would consist of all of the things that an internal auditor had done. So it was a lengthy report with a whole lot of stuff which was actually pretty meaningless and I think actually hid the more important points of the report. And I'd say this is very true of some of the [Organisation XYZ] reports that I saw; they were very cumbersome, multi-multi pages of reports. So I brought it back to very much a listing of what aspects had been looked at, and then it was really all about what we thought was good and what we thought could be improved; so mainly the exceptions stuff. (SM)

An AC also indicates their influence on promoting the key ideas of the report:

One of the things that I've always insisted on is that when the internal audit carries out our review of some section of the company, he writes a report, he shows clearly his recommendations - they don't get buried. Recommendations have to be very clear and straightforward. (AC)

Providers are also aware that reports need clarity, to be succinct and direct, so a reader can easily identify what the issue is, and what is required, but at the same time provide sufficient evidence to support any conclusion. Providers suggested that reports contain adequate information and detail; an example provided was, a reader should not be left wondering if something was not reported because it was not done, or whether it was not reported because there was not an issue.

Another aspect of reporting quality discussed by participants was the need for a report to be attuned to the different stakeholders they are reporting to, for example:

So the quality is actually addressing the needs of the Audit Committee. Who is your main stakeholder? My main stakeholder is the Audit Committee. And is it [the report] addressing what I think the main stakeholder is looking for. So that's where the quality comes in. (IA Head)

An important aspect I see when I look at the reports coming out is how attuned are they to the ultimate user ... So the important piece is to tailor the messaging, recognising as you go up the line they're more time poor, they're more focusing what are the big issues, rather than getting caught up in the detail. So it is making sure that that focus is right to target that audience. Sometimes the challenge is, auditors are very process oriented people generally and like to demonstrate 'I do this, this, and this and then the conclusions here'. Senior management typically tend to come the other way 'tell me what's important and then I might query as to how did you get to that conclusion?' So it is often the other way round, because they don't want to spend you know reading five pages that all the stuff was done and everything was okay. (IA Head)

This quote suggests that a report must be written to match the needs of different particular stakeholders. Again, apparent in this quote is the problem identified of a lack of directness of the key message in reports. Similarly, another IA Head suggested:

I think it is in the detail. ...So at the very summarised level, it is how easy is it, how understandable is the report. So can someone read the summarised report and actually get to the crux of the problem and understand what the issue was. And then in a more detailed report it is how well is the problem documented for people of differing levels of finance or skills. So if you have got different readers, can they read the report and understand what the issue was and why there was a problem, and why the suggested solution is actually going to be better than what is currently happening. So I guess it is its understandability. (IA Head)

Overall, within the theme of effective communication, participants identify a number of important characteristics. Reports must clearly identify the key issue(s) and what the findings mean to the report's recipients and the organisation. Reports need to be clear, direct and provide a holistic view. Reports also need to be balanced and non-confrontational to be persuasive and enable change within the organisation. Other

aspects discussed by participants included: the context of the report – that objectives of the audit are addressed; the articulation of the report – how readable it is; and timeliness of reporting. For example, an IA Partner indicates how important timeliness is of the reports:

In terms of being relevant, the timeliness is a key factor. ... I think if reports are late then, you know that they can be good reports but the focus then becomes just on the timeliness and not on the issues in the actual report. So it is important to have a combination of sound recommendations and relevant and pragmatic and all of that sort of thing, but also to get the reports to them in a reasonable timeframe after the review. (IA Partner)

The last quote identifies the importance of a timely report to be relevant to the organisation. The quote also identifies the importance of pragmatic and relevant recommendations.

The second major theme identified as important to IAF reports is the relevance, quality and pragmatism of IAF findings and recommendations proposed in the reports. As discussed previously, ACs are focused on what the key findings mean to the organisation. SMs indicated the importance of reports as a whole, however, they were far more concerned with specific findings. This often had to do with the fact that in the majority of times, an SM sees a draft report and holds discussions with the IAF before the report is finalised and provided to the audit committee (discussed in the judgment and process sections). So, the findings are the major output factor of the IAF that the SM deal with. An issue often raised by SMs is the low-level findings provided by the IAF; that is, findings that will not help to improve the business. Insights by SMs suggest that SMs perceive the IAF often made these low-level findings to be able to just raise something in the report, so it appears to others that the IAF is contributing something. Others indicated that the IAF just tried to identify as many things as possible without really thinking through the issues. One SM provided the following example:

I find it very frustrating these days that people in these sort of audit roles find a problem and they just hand it straight out without any involvement in actually suggesting solutions. It doesn't give a balanced point of view either, because they will tend to just throw up a whole lot of problems and then you are stuck with prioritising and working through what is really worth fixing and what is not. (SM)

The IAF provider groups discussed the pushback from management when the IAF appeared to be providing these types of low level findings. For example:

The other one where we see negative is where you have audit being seen as overly pedantic, the classic is 'bayoneting the wounded' type of approach; like everyone knows there's a problem here and here comes audit and treats it as if they have made some big discovery. I mean those things need to be raised but how you present those and report those I think needs to be tempered to take into account 'well management was aware of this'; you then look at did they have a plan to address it and give appropriate credit for that. So I think it's those aspects. Or raising things that are seen as, okay the intent of what either the legal requirement or company's internal procedure was being met, but there was some minor administrative aspect that wasn't fully completed and audit then bangs on about that. (IA Head)

Providers also recognised that they must include findings that link everything together for the organisation, part of the big picture again:

Where we can connect I guess themes arising from multiple audits which often, each audit on its own has its own findings, but it's tying those threads together to say look we're now seen this occurring in multiple locations, here is a broader theme or issue that maybe the business more broadly needs to think about. (IA Head)

Internal audit is, they are really expecting that person to join the dots across the organisation. So whilst they've got the privilege that they are being able to delve into areas, you know the length and breadth of the place, the really important thing is how do they pull together that sort of. You know someone who isn't so far down the weeds that they can't see that this is a systemic issue actually; you know 'oh, we are seeing this in this division, and that division', such that they are able to elevate issues that are more systemic across the organisation. (IA Partner)

Pragmatic findings and recommendations were discussed as a real downfall to the quality of an IAF as perceived by SM participants. Internal audit is often not seen as looking at the full picture of what they are finding and where the importance of their

finding sits in the scheme of the business; therefore recommendations are of low quality or unrealistic. One SM suggested:

So yeah, just being a bit more pragmatic, instead of just going 'well that's it, you guys are in big trouble, you didn't do this for three months, you're on the bad list' or whatever it is, if you know what I mean. You know, 'we're going to the Board to talk about this'. (SM)

Most providers appear to be aware of the importance of suggesting pragmatic recommendations. For example:

If we make a recommendation that they need a new rostering system for example, then the reality of them being able to find the investment to invest in a new rostering system is probably somewhat remote. So making a recommendation that that is what they need to do then becomes irrelevant. And this has been an issue with clients in the past in terms of 'well that's fine, but we are never going to get the resources to be able to do it'. So thinking about how you phrase that recommendation becomes more important and in that example, we'd expect to see a recommendation around maybe that they prepare a business case which goes up to the [CEO] to articulate the benefits of investing in a new rostering system for example. So recommendations that require the investment of significant resources, I always get a little bit cautious about, because I think if you don't get the resources then how are you going to mitigate that risk; so there's got to be other ways of doing that. (IA Partner)

This IA Partner is suggesting that thinking through how the business will be able to improve the identified issue will lead to a more pragmatic recommendation. Another IA Head suggested that reports need to contain more than just findings:

It is also not good enough to just come up with issues. For the audit to be worthwhile and in regard to quality, you have to articulate the action, articulate the outcomes, and articulate a timeframe. (IA Head)

In summary, participants identified the quality of reports as the output determinant of a quality IAF. A key theme raised is that reports must effectively communicate the message; therefore, reports must be balanced, persuasive, absolute (holistic), and provide clarity and visibility of key messages and their implication to the recipient and the organisation, within a risk focus. Another theme was that reports must contain

findings and recommendations relevant to the specific stakeholders, be pragmatic so they can be used or implemented, and be important to the organisation in addressing systemic issues.

5.5 CONTEXTUAL FACTORS

This section considers ‘contextual’ factors that participants indicated may affect the quality of the IAF that are outside of an IAFs’ control. Participants identified numerous contextual factors, including factors originating within the organisation and factors from the external business environment. However, the two most commonly discussed factors are the organisation’s culture and attitude towards the IAF, and the ability of the IAF to attract quality staff.

The first theme, the organisation’s culture and attitude towards the IAF (hereafter referred to simply as ‘culture’), was raised by all four groups. Culture towards the IAF is inclusive of the respect for the IAF from senior executives which filters down and affects the culture toward the IAF by management and auditees; the IAF’s status within the organisation; the importance and value of the IAF as part of an organisation’s corporate governance; and the organisation’s culture to embrace improvement and change.

The cultural aspect of the organisation is seen by participants to be driven by the tone-at-the-top – the executives’ philosophy toward internal audit. ACs and SMs identified that a major impediment to high quality internal audit is the executive group’s culture towards internal audit. The following AC stated that the ‘number one’ contextual factor impacting IAF quality is executive support:

There has to be acceptance from the top. This is a really important function and not just a blessing. I think it needs the sort of enthusiastic support of the people at the top and that includes both the board and management. Because a lot of managers think this is a pain in the bum. It

really does, it really requires genuine support on both those sides. That's number one. (AC)

An SM expressed a similar view indicating the biggest factor impacting IAF quality outside of the IAFs control is the importance and status of the IAF imparted by management:

Management's whole attitude towards internal audit would be number one. You know, you can have internal audit as a high priority in a company or you can have it as a low priority; that is a management culture and philosophy. So that to me is probably as important as anything. You know, if they are just having internal audit their as a comfort to be able to say yes we've got an internal audit, there is not much point to that. (SM)

Providers also considered corporate culture and executive support can be a major impediment to performing high quality internal audits. The following quote from an IA Head identifies the necessity to have support from senior executives:

I think the biggest factor is my relationship with the MD [Managing Director], and the support we get and the working relationship we have there ... Because I think if you have an MD that only wants good news, is challenging every report to try and pick holes in it and get things downgraded, the whole relationship changes. And they can influence management to be more or less cooperative; they can influence the Audit Committee. Having that strong relationship, a good working relationship, I would have to say with the MD is critical. (IA Head)

Emerging from the above IA Head quote, is the influence senior executives can have on others within the business regarding their support of the IAF. The attitude towards internal audit of senior executives is perceived by many participants to filter down through all levels of management and auditees. When there is little support for, or a negative attitude towards, the IAF by senior executives, particularly the CEO, respect for the IAF will not be given by others in the organisation. For example, an AC provides a common perspective:

The CEO, the CRO [Chief Risk Officer], they have got to be leading, they have to do a good job of communicating to their team that internal

auditors are actually our friends are not our enemies. ... If you don't have someone with that kind of attitude, I think that would permeate the lower levels who actually have to provide information, be available for meetings, stick to the agreed timetable, all that kind of thing. (AC)

The permeation of culture to lower management in the organisation is supported by an IA Head who indicates the difficulties created for the IAF conducting an audit when there is not a strong culture driven by the executives:

A poor or weak culture is the biggest impediment to my job. And culture is very much driven by management. ... As soon as you get someone in charge who is not so strict, everyone gets a bit lax and they follow the example, or they start to take advantage, and then that makes my job even harder. (IA Head)

Another IA Head suggested:

The amount of support that we get from the Board – if that support is not there then yes it's going to impact on the quality and the perception that other managers may have. (IA Head)

Many SMs acknowledged that it was their duty, and that of other senior executives, to convey the importance and worth of having an IAF within the organisation. These SMs recognised that their attitude toward the IAF can cause an imbalance of respect to the IAF throughout the organisation. Again, the permeation of culture can be seen in the following SM comment:

The degree to which the organisation actually discloses that it is prepared to work with internal audit I think must have a very significant impact on the work that the internal auditor can do, or can present. And, you know, if management is not prepared to disclose, it automatically puts an internal auditor into a position where they have to adopt the bloodhound view; and that is going to end in tears for everybody. So it must be a team view ... otherwise it is not going to work well. (SM)

This quote highlights the multi-facets of management's culture towards the IAF. If management are not supportive of the IAF, the IAF is indirectly placed in a position where they must adopt a policing approach to the audit, not a value-creation approach. This in turn is likely to create less support and respect for the IAF by management and

auditees. SM participants were very aware of this relationship and therefore they suggested they attempt to instil a positive culture towards internal audit.

The culture, driven by the tone-at-the-top, often affects the cooperation and openness of management and auditees. Participants considered this to impact the auditors' ability to conduct high quality audits. For example, IA Heads expressed the effect of culture on the audit:

In terms of areas where you find there's a poor quality outcome is probably areas where the culture is not there from the executive, the tone from the top of that portfolio, for a whole host of reasons. ... You find that they're defensive, they're aggressive/defensive, they do not disclose anything, they do not engage at all. (IA Head)

On the management side, we have some parts of the business that there is a very good positive constructive open relationship, robust. Other parts of the business sometimes it's more around seeing us as something that needs to be managed and controlled rather than having an open as culture as you would like; it is more around we don't want the bad news to get out type of culture. And that can be more challenging to the team to work with that. (IA Head)

Participants also suggested the culture towards the IAF, or a 'secretive' culture, influenced management's and auditees' willingness to work collaboratively with the IAF, such as providing necessary information, as noted in the following two quotes:

Well I guess you can only ask the questions that you know to ask. So if people haven't told you everything, or even maybe not intentionally not told you everything, then you won't know what questions to ask, or you may not necessarily ask the right questions. And it doesn't matter how well you know the business, if you haven't got all the facts then things could be missed. (SM)

There are very few issues that the client won't already know before we go in there. ... At the end of the day, whilst we'll do testing and all that sort of thing, we are heavily reliant on the information that's provided to us to form the conclusions we form. So if we're not getting the right information, or people are withholding certain information from us, then it can be very difficult to identify all the issues and risks; so that's a challenge. And hopefully, you know the process we go through to close out issues and finalise reports eliminates a lot of that. ... That's probably the biggest sort of challenge and the biggest impediment to the review. (IA Partner)

The majority of views provided by participants considered the organisational culture affecting management's and auditees' cooperation, openness, and willingness to work with the IAF, to have a the negative impact on IAF quality. However, in contrast, the following IA Partner, whilst recognising management support will affect the audit, considered that low support would only affect the efficiency of the audit and not the quality:

People not being forthcoming with information, people not making the time, which I guess is the same, if they don't have the time or they are unwilling to commit the time to complete the work. It probably, it almost just creates difficulties in completing the internal audit, like you would still need to do that but it then might impact the time it takes to complete the internal audit. It might mean that the scope overruns, so we actually have to go back to the client and ask for additional fees. So I think the outcome would be the same but the way in which we've got there would be slightly different. (IA Partner)

Participants also recognised that a firm's culture towards improvement and change is likely to affect the quality of the audit. This sentiment is expressed by the following IA Partner:

So one of the biggest challenges in the role is actually that level of closeout [of an audit engagement] because those people, how they feel, the feedback reflects on them personally. And then that's also an organisational cultural thing. Because an organisation with a good open culture and willingness to learn will accept all that very well; but a more defensive culture, that can be actually quite a difficult part of the audit where you need senior people involved to make sure that it's not, the issues aren't downplayed. So if you want to know about quality and where things can get downgraded, it is at that point where the biggest risk is. (IA Partner)

Here, the IA Partner alludes to the need for 'senior people' such as the audit committee or senior executives to support the IAF in their findings and recommendations.

Part of the corporate culture towards the IAF is exposed in the status of the IAF within the organisation. Many participants indicated that the organisational status of the

IAF advocated by executives is a symbol of the importance of the IAF perceived by senior executives and the board. Some ACs provide a perspective on this:

It is an unfortunate fact of life that internal audit is often perceived as being a lesser valued part of the organisation. But that often only occurs in those organisations where they focus on the ticking and flicking side of it, rather than whether or not the internal audit group can offer true insight. ... My experience has been that often internal audit is not seen as being the most, a significant part of the management structure; it is often seen as being something more in the nature of a must have – so let's put them in the back corner rather than must have because we think that they will provide good input. (AC)

The internal auditor, I think has little more trouble often in being treated with real respect or authority by other members of the management team. Typically they are not senior enough to be included in the executive group or whatever you want to call it, the top seven or eight, they will normally be one down from there. That is not true [here] at the moment, because in [Organisation XYZ] we broadened, the woman who holds that role [Head of IA] sits across risk and compliance as well; and that broadening has made her one of the top eight – and I think that is a very good thing. But there is a tension there of 'we are all on the same management team therefore we are all meant to be collegial and you are being a nitpicker, and you are getting in my way, and you are costing me and distracting me and why don't you stop it'. (AC)

The majority focus of these quotes – and others from alternate groups – is that the status afforded to the IAF within an organisation's hierarchy will influence the importance of the IAF and the respect they receive from others in the organisation. The last quote also provides insight into alternate difficulties or pressures created on the IAF when the IAF head is considered part of the executive group.

Another impact of the status of the IAF and executives' attitude towards the importance of the IAF is reflected in an IAF's budget. IAF budgets were raised by only a few participants, mainly IAF providers, who outlined that constraints to their budget can be an obstacle to performing high quality audits. For example, the IAF may not have the required staff, the necessary time to stay on projects to fully identify all issues, or they will be able to conduct fewer amounts of audit engagements overall, limiting

their ability to provide the holistic picture some stakeholders desire. An AC recognised that one of the first things to be cut back when management needs to tighten budgets is the IAF:

If management comes under pressure – you know they've got their own KPIs, they are trying to earn their incentives and so on and so forth – if you start missing on your earnings targets or something like that, the tendency is to screw down on some discretionary expenses. And we know what happens, it has happened in business forever, you screw down on the advertising budget a little bit, on new product development, on recruiting, on training, and superfluous types of things like internal audit if you're not careful. And management has that incentive to treat it [the IAF] as a nice to have, not a must have. And part of the Audit Committee's function is to say 'hands off!' (AC)

This AC statement reveals the necessity of having a strong audit committee who will ensure the IAF is well supported. A number of IA Partners also suggested audit committee's need to challenge management on budgetary issues. This notion of audit committee support has been identified from a number of quotes presented. AC, IA Head and IA Partner participants mentioned the strength and leadership ability of the audit committee is important to IAF quality. This sentiment is highlighted in the following AC perspective:

I'm of the view that the people that can have the most influence on the quality of the internal audit are actually the audit committee members. Because as a member of the audit committee you are insisting on a thorough internal audit process ... you're showing them that your genuine about understanding what they're seeing in the business, your genuine about implementing their recommendations or certainly engaging in a robust conversation about their recommendations and you're genuine about the application of the outcomes. I think that sends a message very clearly to them, you know, what your expectations are from them and I think it probably makes them more comfortable to do a better job. Whereas if I think, they're getting a sense that you're doing it because you feel you have to, you know you're going through the motions, then I suspect they're not going to be as inclined to do as good a job. (AC)

This AC is referring to the importance of working with the IAF to ensure that they are aligned, and the IAF is set on achieving a high quality internal audit. Participants also

described how audit committee leadership sends a message to the rest of the organisation that the IAF is important to the audit committee and therefore should be important to the rest of the organisation as well. This sentiment is depicted in the following quote:

The fact that I as the Chair of the Audit Committee have a close working relationship with the internal auditor also enhances his/her position. So I think that is very important for the people in the organisation to know that the internal auditor really is part of the, sort of, the senior group. Mind you, that can work against them because if they think he or she is actually in the pocket of the chief executive then the scuttlebutt is not going to flow. So it's a tricky position. But I think overriding that, I think the status of the position is important and that structure gives that status.
(AC)

Again, the status of the IAF is raised in this quote, this time with the suggestion that it is the audit committee who needs to promote the IAF's status. This AC did express concern that the status of the IAF can also cause different difficulties, in that an IAF positioned in the organisational hierarchy with the chief executives may limit the amount of information provided to the IAF.

A second theme raised by participants that can affect the quality of the IAF which is outside the IAF's control, was an external factor regarding the difficulty in attracting and recruiting high quality people into internal audit. AC, IA Head and IA Partner participants discussed this issue. Overall, participants gave two reasons for the difficulty of hiring quality individuals. Firstly, that there is a lack of people with the ability including the skills, personality and acumen (as discussed in the IAF input section) to be a good internal auditor. Secondly, a career in internal audit is not perceived as overly attractive as a result of unappealing career opportunities, remuneration and the stigma of internal audit. ACs were the biggest discussant on this issue; the following AC summarises both of these two reasons:

It's always a challenge to get the right people in internal audit. Internal audit is not seen as a sexy occupation. And ... it takes a certain person to be an internal auditor. Many times internal audit is seen as a career progression, a passage through to further opportunities, not a long term career possibility. (AC)

A few salient statements elaborate on the unappealing nature of an internal audit career:

Part of the reason why it's not taken up very much is that internal audit still has a pretty unexciting appeal within the organisation. It is generally seen as, as old men in cardigans that don't do a lot. That was more prevalent 20 years ago, but it's still the case in a lot of organisations, that, if I was a up-and-coming young, bright young thing in the organisation, in a lot of places it wouldn't be seen as a positive career step to go into. (IA Partner)

People don't really want to see themselves in internal audit. External audit is where the game is at. This is one of the biggest challenges for internal audit – the stigma attached. So it is very hard to get career people in. On top of that, if an internal auditor is so good, he won't last; the firm will promote him or he will be head hunted to another position. (AC)

This last quote reveals a further problem for achieving high quality internal audit, in being able to retain high quality people within the function. Another AC commented on the difficulty in attracting a person with specialist skills, giving the example of an I.T. specialist:

I.T. auditing is becoming more and more sophisticated, more and more critical ... and people who are really good at I.T. don't want to do I.T. auditing. They want to build new systems, design new architectures, write new software, all those much more exciting things. (AC)

This quote is in reference to the industry as a whole, suggesting people with specialist skills are unlikely to become internal auditors as there is more appealing work available.

In summary, two themes regarding contextual factors that can affect IAF quality were discussed consistently among participants. The first theme was the culture of the firm and the firm's attitude towards internal audit, which included the status of the IAF within the organisation. Culture begins with the senior executives and filters down through all levels of management and auditees, influencing their respect for, and

cooperation with, the IAF. An open culture and supportive philosophy can positively enhance IAF quality while a negative culture that is defensive or secretive reduces IAF efficiency and effectiveness and can affect IAF quality. The second theme was the difficulty to obtain quality staff for the IAF, which is a result of a lack of people in the industry with the attributes necessary to be a quality auditor, and the perceived unattractive appeal of becoming an internal auditor.

Participants also identified and discussed numerous other contextual factors that can affect IAF quality. These factors were not consistent over many participants, often identified by a small number from one group or perhaps one person from various groups. These factors are reported below to provide an indication of the various and multiple factors that may affect IAF quality. These other factors included: cultural differences internationally for multi-national organisations that the IAF must be aware of and audit accordingly (discussed by SMs); increased regulatory and industry factors (such as unions) (discussed by SMs, ACs and IA Heads); the economic environment which impacts business strategy and risk appetite (discussed by IA Partners); a restructure within the organisation, such as a merger and acquisition or new product/system implementation (discussed by SMs, IA Heads, and IA Partners); the quality of data (discussed by IA Heads and IA Partners); and the understanding of the IAF role within the firm by all governance participants (discussed by ACs and IA Partners).

5.6 DISCUSSION

This discussion is organised around four premises. First, the importance of individual factors raised by participants under the respective dimensions contained within the IAF quality framework. Second, the efficacy of the IAF quality framework developed in Chapter 2 based on the findings to this research question. Third, how the

factors identified in this research relate to conceptualisations of IAF quality within prior research (and external audit standards) and from the IIA, and to quality models and frameworks considered in the development of the IAF quality framework. Fourth, the implications of these findings on the measurement of IAF quality.

Earlier in this chapter, under each dimension of the IAF quality framework, a summary of the key factors considered by participants to be determinants of a quality IAF is provided. Overall, the findings suggest that each of the dimensions within the IAF quality framework are made up of a number of important factors considered as determinants of a quality IAF. Table 8 provides an overview of these factors under their respective dimension.

5.6.1 IMPORTANCE OF IAF QUALITY FACTORS

All four participant groups emphasised that, within the input dimension, internal auditor attributes related to service quality are more important than technical quality attributes. These service quality attributes are an internal auditor's soft skills and their personality traits. Participant examples and discussion indicated soft skills and their personality traits often differentiate a high quality auditor from a lower quality auditor. This was particularly emphasised for soft skills which are considered critical to high quality internal audit. The following statement by one IA Head indicates why this may be the case:

Internal audit is more of an art than a science these days; but you do need the science too. (IA Head)

ACs and SMs strongly identified with this statement and emphasised the importance of the service attributes (soft skills and personality) rather than technical skills and experience. They reasoned that the technical attributes can be provided to an individual, that is, internal auditors can be trained or given experience, but the service attributes are

innate to the individual. However, as the above IA Head statement identifies, technical quality attributes are still necessary. The ACs and SMs did suggest they were important, and a base for high quality internal audits and provide some comfort that the audit will be technically adequate.

The importance and discussion of technical attributes was mainly offered by the two internal audit provider groups. A potential reason for the importance of soft skills and personality traits over technical skills and experience was provided directly and indirectly by participants – most organisations will outsource their IAF, or particular audits, if they don't have the technical proficiency to conduct the audit to a sufficient level of quality. This finding of technical skills and attributes being more important to the provider groups is contrary to expectations as providers are likely to know when they do not have the technical proficiency to conduct the audit and can therefore externally source the audit or acquire assistance. Whereas the users who have less knowledge of the competence of the IAF to conduct the audit, did not place much importance on the technical skills or attributes of the auditor within IAF quality.

The above findings of this study related to the input dimension support prior research findings. Lampe and Sutton (1994) find an internal auditors education level and professional certification are considered unimportant, and both Arena and Azzone (2009) and Gramling and Myers (1997) find that internal auditor competencies are not influential on perceptions of those who are relying on IAF information. Abdolmohammadi (2012) identifies a similar range of important attributes of the internal auditor. He finds leadership skills are most important for the head of the IAF, but technical skills most important for junior auditors, with the importance of technical skills decreasing as the internal auditor increases in rank. Overall, Abdolmohammadi (2012) finds more support for technical skills than the present study, however, his study

used perceptual data of CAEs; findings of this research question indicate technical skills are considered more important by providers of the service compared to the users, but still less than service attributes. This supports the notion of this thesis that considering a wider array of stakeholders provides greater insight into IAF quality.

An internal auditors' objectivity was inferred by participants to also be an important attribute of the internal auditor. Many low quality examples of IAF engagements were based on objectivity issues. There was, however, a divergence of views on the necessity of IAF independence. That is, participants saw a difference between the importance of objectivity and independence; where the IAF does not necessarily need to be independent of management but it is crucial they remain objective. This divergence complements findings in RQ2 that assessments of IAF quality are driven by alternate theoretical perspectives, such as agency theory and resource dependency theory.

Also part of the input dimension is the structural elements of the IAF. ACs were insistent on direct IAF reporting lines to the audit committee as a factor of IAF quality, consistent with an agency theory perspective (Cohen et al., 2008; Hermanson et al., 2012). A structural element discussed by participants within all groups as positively enhancing IAF quality was the practice of using the IAF as a MTG. This practice enhances an IAF's skill base, understanding of business objectives and promotes stronger relationships. There are also benefits to management which are perceived to then increase management's support of the IAF, which could be seen as a win-win situation for all parties. In contrast to the support found for this practice in this study, Messier et al. (2011) find external auditors perceive this practice impairs internal auditors' objectivity and therefore they rely less on IAF work when the IAF is used as a MTG. However, objectivity impairment related to the use of the IAF as a MTG was not

discussed by participants of this thesis. As the use of the IAF as a MTG is common (Abbott et al., 2010; Messier et al., 2011), a pertinent area for future research is to investigate the differences between this thesis and Messier et al.'s (2011) results to determine if the differences are due to different IAF stakeholders and/or the research method.

Each stakeholder group considered factors within the process dimension important to IAF quality. All groups maintained that an IAF's ability to be of high quality (and add value) does not simply depend on strong input attributes, but the process of how the audit is conducted. Under the process dimension of the IAF quality framework there was minimal discussion about specific methodologies employed in internal auditing. Most discussion on this dimension was on the service aspect of the function; the important factors were the IAF's relationships with others in the business, working collaboratively with management and auditees to achieve the best outcomes for the organisation, and the closeout of the audit.

The closeout of the audit is an interesting area where SM, IA Head and IA Partner groups suggested the importance of this process to achieve the best outcomes, and for the IAF to be respected by management and auditees. ACs also suggested this was an important process factor as they do not want findings to be raised in audit committee meetings where management disagree and therefore waste time in those audit committee meetings. This finding for ACs supports previous research identifying that audit committees want disputes between management and external auditors solved by these two parties (Cohen et al., 2010; Gendron and Bédard, 2006). As the AC groups in this study did not want to be the adjudicator of disputes between the IAF and management, this suggests that there is likely to be a lot of negotiation between the IAF and management which is an opportunity for future research in this area.

Commercial understanding of business objectives and the audit area is considered a critical factor for the IAF to be of high quality, supporting findings in previous research (Abdolmohammadi, 2012; Lampe and Sutton, 1994; Protiviti, 2012). Another important process factor is the approach the IAF takes to the audit. When an IAF is focused on internal compliance ‘tick-and-flick’ audits, the majority of participants view these audits as being of low quality and low value to the organisation even though the audit may have been performed at a technically high level of quality. Many participants also view a quality audit approach as being about auditing the future, not just auditing the past. As identified in the findings of this research question, the respect for the IAF has implications for IAF quality. An IAF taking a ‘tick-and-flick’ approach decreases respect for the IAF, which indirectly forces the IAF to adopt this approach on future engagements as management are likely to be less willing to work collaboratively with the IAF. This finding has implications for the IAF’s role within an organisation and the imperative to understand what each stakeholder requires from the IAF.

Outputs were discussed as a key determinant of IAF quality. Reports are the IAF’s deliverable and therefore a report viewed as low quality is a strong reflection on the quality of the overall audit. The common reflection was that if the results of the audit cannot be communicated effectively, then the audit will be deemed to be of low quality. The quality of outputs as a factor in IAF quality supports earlier findings of the importance of output factors. For example, Lampe and Sutton (1994) identified that out of many factors considered, IAF reports have the greatest effect on quality. Further, audit committee members consider the outputs of external audits – the external audit reports and communication – as a significant determinant of external audit quality (Deumes et al., 2012).

Previous research finds that contextual factors outside the control of the IAF, such as firm culture (Krishnamoorthy and Maletta, 2008; Lampe and Sutton, 1994; Margheim and Label, 1990), and an audit committee's quality and support of the IAF (Abbott et al., 2012; Cohen et al., 2007a; Felix et al., 2001; Gramling et al., 2004; Krishnamoorthy and Maletta, 2008; Lampe and Sutton, 1994) affects IAF quality and subsequent external auditor reliance on the IAF. Participants in this study identified both of these contextual factors as determinant factors of a quality IAF. Management's attitude sets the tone for governance (Cohen et al., 2002); findings of this study indicate that tone-at-the-top, that is, executive management's culture and respect for internal audit will filter down through the layers of the organisation. The importance of these findings is that low quality IAFs may not always be the fault of the internal auditors, suggesting that organisations need to consider these factors when assessing the quality of the IAF. Participants also identified another factor which is the difficulty in attracting quality staff to the IAF.

This discussion has contained the participants' inferences as to the importance of the many different input, process, output, and contextual factors that affect IAF quality. Krishnamoorthy's (2002), discussion on the external audit 'three factors', contends that no factor should be considered more important than another factor, as the importance of a factor may decrease if other factors are unsatisfactory. The findings of this research provide an example of Krishnamoorthy's proposition. Soft skills were clearly more important than technical skills to these IAF stakeholders groups as a factor of IAF quality; however, without the base technical skills to conduct the audit, having the 'right' soft skills would be unimportant. Despite Krishnamoorthy's proposition, this thesis contends the discussion on the importance of factors is necessary, as the objective

of the research question is to increase our understanding of IAF quality and to determine what factors IAF stakeholders consider important determinants of IAF quality.

5.6.2 EFFICACY OF IAF QUALITY FRAMEWORK

Based on theory of quality conceptualisation for services and tasks, the IAF quality framework was developed in Chapter 2 and predicts that IAF quality consists of the dimensions inputs, processes, outputs and outcomes, each of which can be impacted by contextual factors. Above it has been shown that stakeholders consider factors within each of these dimensions as important for a quality IAF. Therefore, the findings provide support for the appropriateness and coverage of the framework.

Further, the framework explicitly separates each dimension arguing that there is not a direct linear relationship between the dimensions. That is, high quality inputs do not automatically create high quality processes; and high quality processes do not automatically create high quality outputs. Consistent with the IAF quality framework, findings from this research question indicate that quality can be influenced within each dimension, no matter the quality of the preceding dimension(s). The common example offered by participants was that if an IAF report (output) is of low quality, then the audit is considered low quality; this was the case even if IAF inputs and processes were of high quality. However, the findings indicate there is still a strong relationship from inputs to processes to outputs and outcomes, which lends support to prior IAF quality research and measures. The participants were strongly of the view that high quality internal audit starts with high quality internal auditors – the internal auditor is the base. If the IAF does not have quality internal auditors (inputs), it is hard to have quality processes; if there are not quality inputs and processes, it is hard to have quality outputs. However, it is important to again emphasize there is no certainty or guarantee that high quality inputs lead to high quality outputs because quality can be downgraded in

processes and outputs and affected by contextual factors. Overall, the findings provide support for the efficacy of the IAF quality framework developed.

5.6.3 COMPARISONS TO CONCEPTUALISATIONS OF IAF QUALITY

In this section, comparisons to other conceptualisations of IAF quality are discussed, including prior IAF quality research, the external audit standard prescriptive model, internal audit standards, and lastly a comparison to the conceptualisation of quality presented in the interdisciplinary review.

As discussed in Section 2.2.2, prior research on IAF quality has conceptualised measures of IAF quality based on a prescriptive model provided in external audit standards. These external audit standards contend that an external auditor must assess the IAF's competence, objectivity and work performance to establish the quality of the IAF. The IAF quality measures of prior research have operationalized competence as experience, certification and training; objectivity as the IAFs reporting relationship (lines of communication); and work performance as focus on financial reporting related activities (see Table 2 for a review). The findings of this thesis indicate that each of these external audit 'three factors' are considered by the other IAF stakeholders as factors of IAF quality. Competence is considered as experience and technical skills; objectivity is considered by individual objectivity and lines of communication; work performance is considered by meeting stakeholder requirements. However, as discussed above, participants consider many more factors as determinants of the quality of an IAF, and considered the importance of many of these other factors above the 'three factors'. Thus, based on these findings, a measure based on the external audit standards prescriptive model of IAF quality is unlikely to be capturing all relevant information to assess IAF quality and may not be appropriate for IAF stakeholders besides the external auditor.

The IIA contend that a quality IAF is achieved through conformance to internal auditing professional standards (IIA standards) and meeting stakeholder expectations (2010). This thesis establishes that meeting stakeholder expectations is considered by participants as crucial to be considered a high quality IAF. However, an interesting finding is the minimal discussion by participants on IIA standards as a determinant of the quality of an IAF. Nevertheless, the IIA standards do contain many of the factors identified by participants. A possible explanation for the lack of discussion on IIA standards by the AC and SM participants is that these users are unaware of the standards. However, there was also a distinct lack of importance given to IIA standards as a determinant of IAF quality by both provider groups. Thus, it is possible that AC and SM participants are aware of IIA standards but do not consider them an important factor in IAF quality. Consistent with this view, Bolger (2011) highlights that most audit committee members, CFO's and directors are aware of professional internal auditing standards but many do not consider compliance critical. Within the provider groups, only one participant actually stated the importance of IIA standards to IAF quality. It appears that most internal auditors do not consider conforming to standards as important for IAF quality. This is consistent with recent studies which indicate conformance to IIA standards is low; Bailey (2011) finds 46% of IAFs conform, Protiviti (2012) find only 31% of IAFs conform and that conformance is even decreasing.

This is an important finding and raises implications for the IIA. One issue may be the generic nature of IIA standards; for instance, the only IA Partner who provided a discussion on internal auditing standards suggested:

Internal audit standards tend to be a couple of paragraphs and then you have sort of guidance notes. Whereas, external audit standards are like,

well they're all like Grisham novels – so very prescriptive, much much more prescriptive, so there's quite a difference. (IA Partner)

Abdolmohammadi (2009) calls for research to determine under what circumstances would IIA standards be considered to contribute to quality. While not answering this question per se, these results suggest conformance, or use, of standards are not considered part of a quality assessment or a determinant of IAF quality for this group of participants.

The findings of this research question are now briefly compared to frameworks and models identified in the interdisciplinary review (Section 2.3) that were used to inform the development of the IAF quality framework. The model of quality proposed by Gronroos (1984) proposes quality is a mix of technical quality (the outputs and outcomes of the service) and functional quality (the service interactions and delivery). Many of the factors discussed in this Chapter, and those considered as most important, fell under these two quality elements. Specifically, the factors within the output dimension, such as reports, findings and recommendations match Gronroos' technical quality dimension. Factors within the process dimension such as relationships and interaction, and the service attributes of the internal auditor within the input dimension, match Gronroos' functional quality dimension. However, the closest match between RQ3 findings and an alternate discipline conceptualisation of quality is with the framework of external audit quality proposed by the FRC. The FRC framework provides five key drivers of external audit quality: the skills and personal qualities of auditors, the effectiveness of the audit process, the reliability and usefulness of audit reporting, factors outside the control of auditors affecting audit quality, and the culture within an audit firm (FRC 2008). Except for the factor 'culture of the audit firm', the determinant factors identified by participants in this study map very closely to the FRC proposed drivers.

5.6.4 IMPLICATIONS FOR IAF QUALITY MEASURES

Current measures of IAF quality are appropriate for ex-ante assessments of IAF quality. The ‘three factors’ are an indication of the ability of the internal auditor to perform the internal audit at a high level of quality. However, as Bonner (2008) notes, in practice it is more common for people to assess quality via outputs or outcomes, that is, an ex-post assessment. The benefit of the current measure is that the factors are objective and easily identifiable, but as discussed the measures do not contain an IAF’s performance and are only predicting high quality output and outcomes from high quality (higher quantities) inputs. An issue with the majority of factors espoused in these findings is that they are subjective perceptual concepts. Therefore, these factors will be difficult to measure for anyone outside of the stakeholder groups. As such, researchers may have difficulty in measuring or adopting proxies for these factors. However, a measure containing more than the ‘three factors’ is likely to be a stronger indicator of IAF quality. Therefore, including any of the factors identified here, particularly from the process, output, and contextual dimensions will provide a more accurate representation of the quality of the IAF. The difficulty will be for researchers to operationalize these factors, but this is a potential consideration for future research.

Chapter 6: Conclusion

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6.1 OVERVIEW

An organisation's IAF is a key component of their corporate governance system (Anderson et al., 2012b; Prawitt et al., 2009). IAF information is utilised by governance actors in forming judgements and making organisationally critical decisions. The usefulness of the information provided by the IAF depends on the governance actors' perception of the quality of the IAF. This thesis addresses two limitations in the prior IAF quality literature. Firstly, the thesis adopts a richer conception of quality drawing on other service quality disciplines. The prior literature has conceptualised IAF quality narrowly based on the prescription within external audit standards (AICPA 1990; PCAOB 2007; IFAC 2009c) requiring external auditors to assess the quality of an IAF via three factors: competence, objectivity and work performance. Secondly, the thesis adopts a multi-stakeholder perspective and investigates IAF quality from the viewpoint of three IAF stakeholders, namely, the audit committee, senior management and the internal auditor. The prior literature has almost exclusively been limited to the consideration of one governance stakeholder – the external auditor.

To develop new insights into IAF quality 36 semi-structured interviews were conducted with participants from large Australian firms across the IAF stakeholder groups. Participants included audit committee members and chairs, senior management,

heads of in-house IAFs, and partners of IAF divisions from large accounting firms. This thesis builds on the perceived relationship between IAF characteristics and high quality IAF output and explores conceptualisations of quality and quality measures in other service and task disciplines. This review identified that quality is a multi-dimensional construct, is different for the multiple users of the service or task, and is contextual. From this review, a framework of IAF quality is developed and tested against participants' views of quality IAFs. The framework contends IAF quality consists of five inter-related but non-causal dimensions, namely inputs, processes, outputs, outcomes and contextual factors. In contrast, the prior IAF quality research has focused on inputs to the function to predict the ability of the auditor to perform a high quality internal audit and some factors outside of the control of the IAF that may affect the IAF's ability to conduct high quality internal audits. These studies have largely ignored IAF processes, outputs and outcomes.

Participant responses indicated that in the judgment of IAF quality, the multiple IAF stakeholders use different information cues in their judgment of the quality of the function. Audit committees' information cues are based within the output dimension; senior management predominantly use outcomes as their information cue, supplemented by outputs. IA Heads' information cue is based on the process dimension, whilst IA Partners use both outputs and outcomes as their information cues. These findings differ from that of an external auditor, whose information cues are based on factors within the input dimension.

These findings are also considered in relation to predictions of multiple corporate governance theories. Interview data suggests that three theories explain the motivation behind IAF quality judgments. Audit committee judgments are consistent with predictions of agency and resource dependency theories. Senior management and IA

Partners' judgments are consistent with resource dependency theory. The IA Head judgements are consistent with predictions of stewardship theory. The objective of this research was to establish how judgements are made and determine if there are differences in judgments amongst stakeholders. Formally testing the various corporate governance theories is therefore beyond the scope of this thesis. However, given the finding that the judgements of the corporate governance actors are consistent with predictions of multiple theories suggests a pertinent area for future research.

This thesis also investigated the wider menu of factors IAF stakeholders consider determinants of a quality IAF. The factors proposed were quite similar across the different stakeholders. The factors also mapped closely to each dimension within the IAF quality framework proposed in the thesis. More importantly, participants identified a greater number of factors than currently considered in IAF quality research, and many were often regarded as more important factors. The insights from these findings suggest that IAF quality is more complex than our current understanding.

The findings of this thesis provide support that the IAF quality framework developed in this thesis is a reasonable representation of the IAF quality construct. Overall, the insights reveal that quality is more complex than has been considered in the literature and important corporate governance actors will judge IAF quality differently. This thesis is a first step towards a more comprehensive understanding of IAF quality beyond a single governance stakeholder, and beyond understanding IAF quality in relation to activities only associated with external financial reporting. IAF quality is multi-dimensional and each dimension consists of numerous important factors that can be determinants of a quality IAF. These various dimensions and factors must be included for an effective and comprehensive measurement of IAF quality in future research.

6.2 CONTRIBUTIONS OF THIS THESIS

The contributions made by this thesis to both theory and practice are discussed below.

6.2.1 CONTRIBUTIONS TO THEORY

This thesis makes five specific contributions to theory. First, this thesis extends prior IAF quality research to include the perspectives of multiple IAF stakeholders, namely the audit committee, senior management and internal auditors. By incorporating these stakeholders, this thesis provides a more holistic and comprehensive understanding of IAF quality. Not only, does this thesis include stakeholders not considered previously in IAF quality research (Gramling et al., 2004), but includes management and internal auditors who are often not considered in governance research (Carcello et al., 2011).

Second, this thesis developed a theoretical framework of IAF quality that captures a broader range of dimensions of IAF quality than is currently considered in the literature. In building the framework the thesis draws on alternate disciplines conceptualising quality for services and tasks. The framework extends the IAF quality concept beyond that envisioned by the traditional narrow external audit focus. Each dimension of the framework is perceived by IAF stakeholders as important to IAF quality. Going forward, this theoretical framework represents a richer base for future IAF quality research.

Third, the empirical findings from this thesis provide initial support to the theory that IAF quality is a multi-dimensional construct which is influenced by a number of important factors. Further, the evidence suggests that IAF stakeholders use different information cues to judge IAF quality. Therefore this thesis provides preliminary evidence that IAF quality is determined by more than the ‘three factors’ (input factors)

prescribed in external audit standards. Whilst confirming these ‘three factors’ are considered important by stakeholders other than the external auditor, the results indicate IAF quality is significantly broader than the literature’s understanding. Significantly many of the new factors identified are considered more important as determinants of IAF quality.

Fourth, some salient features of this thesis address important areas in corporate governance and internal audit research. This thesis employed an alternative research method to study IAF quality beyond surveys and experiments (Gramling et al., 2004), and governance research beyond archival data (Carcello et al., 2011). Through taking a field study approach the results captured the views of stakeholders involved with the IAF on a regular basis. Further, the research leveraged theory from a variety of alternate disciplines (Carcello et al., 2011) and considered the findings compared to a variety of theoretical perspectives (Gendron, 2009; Hermanson et al., 2012). Through investigating responses against prescriptions of corporate governance theories, this thesis adds to the recent body of literature which identifies that corporate governance processes can be explained by more than just an agency theory perspective (Beasley et al., 2009; Cohen et al., 2010; Cohen et al., 2007b; Hermanson et al., 2012).

Fifth, the results and framework from this thesis adds to the broader quality measurement literature outside of the internal audit discipline. The findings provide support that many of the current frameworks and models are appropriate in that they are multi-dimensional and focused on multiple stakeholders.

6.2.2 CONTRIBUTIONS TO PRACTICE

The findings of this thesis provide important insights to organisations that employ an IAF, those who rely on IAF information, the internal audit service providers and governing bodies such as the IIA and corporate governance regulators. An

understanding of the factors IAF stakeholders consider determinants of IAF quality provide important insights to organisations. These insights can guide organisations on where to direct efforts to improve the quality of their IAF. Improvements in IAF quality should increase the reliance on the IAF.

The insights from this thesis provide the users of internal audit services with both an understanding on how other stakeholders assess quality and what they consider important factors of IAF quality. This understanding can be incorporated into their decisions and actions regarding the IAF to ensure a quality function for all users. The framework can also be employed by users required to undertake formal assessment of the IAF. Internal audit providers can use the insights of this thesis to understand how their clients judge their performance and the factors they consider important determinants of a quality IAF. This provides the internal auditors the knowledge to perform high quality audits that best meets the needs of, and provide value to, their clients.

This thesis also provides a number of insights for the IIA. For instance, the IIA can incorporate these findings into relevant training and advisory processes. Further, as the IIA consider conformance to internal auditing professional standards imperative to IAF quality, further consideration needs to be given to the fact that participants placed little emphasis on this issue. Furthermore, corporate governance regulators who require or recommend organisations to maintain an IAF can improve guidance on the necessary requirements of an IAF to meet quality demands and be a resourceful corporate governance mechanism.

6.3 LIMITATIONS OF THIS THESIS

This thesis contains a number of limitations that must be considered when interpreting the results. The first limitation is the size of the sample. The nature of semi-

structured interviews provide very rich data, however their use inherently limits the size of the sample (Cohen et al., 2002). The sample contained 36 individuals, which as a sample is consistent or greater than many recent audit and governance interview studies (e.g. Beasley et al., 2009; Cohen et al., 2010; Hermanson et al., 2012). However, compared to archival and experimental research, this is a small sample. Further, this sample has four distinct groups of participants and therefore the average sample size for each group is nine participants. However, the consistency of responses within these groups adds credibility to the results. Due to the nature of this research, a semi-structured interview approach is considered appropriate to trade off quantity to obtain experienced participants and in-depth insights.

Second, the participants of this study represent a non-random sample. This limits the generalizability of the results to the broader population of audit committees, senior management and internal auditors. Further, the interviews were carried out in Australia with participants from very large firms. Recent research suggest IAFs may be at different stages around the world (Anderson et al., 2012b), different attributes of internal auditors are more important under different international cultures (Abdolmohammadi, 2012), and different contexts such as legislative requirements and firm size affect the IAF (Arena and Azzone, 2009). Again, this limits the ability to generalise the findings of this research.

Third, there is a potential concern of responses being artefacts of the research approach. For example, it is possible important insights were not revealed (Hermanson et al., 2012); perceptual bias by respondents based on previous experience with the IAF; concern of selective recall (McCracken et al., 2008); the differences in IAF roles and status amongst organisations; responses being perceptual in nature; and interviewer bias. However, by evoking experiences and eliciting responses about both high and low

quality audits, and the consistency of responses across participants in each group, the findings are perceived as an accurate representation of IAF quality.

Fourth, attempts were made to obtain an audit committee member, a senior manager and the head/partner of the IAF within individual organisations to help account for differences in IAF quality across firms and not just differences across positions. Unlike Cohen et al. (2013a) who were able to attract the ‘triad’ (an audit committee member, the CFO and the firm’s external audit partner) from individual firms, this opportunity was unattainable for this thesis. Again, due to the nature of this research trying to build our understanding of IAF quality, the seniority of participants and the size of organisations they represent, this limitation is not perceived to detract from the importance of the findings in this thesis.

These limitations suggest caution in interpreting the thesis’ evidence and invites further research to build a body of evidence so a broader based conclusion can be reached.

6.4 FUTURE RESEARCH OPPORTUNITIES

The richness of the data collected for this thesis raises many ideas and possibilities for future research of the IAF, and IAF quality, within the corporate governance mosaic. This section provides an overview of some of these potential opportunities. Firstly, using alternate research methods such as survey data or experiments, future research needs to corroborate the findings of this thesis, particularly with a larger sample size. Experimental research can also examine under what conditions the determinants of IAF quality are important, and the reasons for these effects.

The findings of this thesis indicate that IAF quality is more complex than simply the IAF inputs. IAF quality appears to be influenced within each dimension of the IAF

quality framework. Using these findings and the IAF quality framework as a starting point, an opportunity exists to develop a comprehensive model of IAF quality. The similarity between groups on the factors considered as determinants of IAF quality suggests a multi-dimensional, multi-stakeholder model is possible. However as discussed earlier, this thesis has only identified the important dimensions and the factors important within the dimensions, not how to measure them. One difficulty may be that as some of the factors are very subjective they may not be operationalizable (Stvilia et al., 2007) but this is an issue for future research to investigate.

An important future research opportunity exists in identifying how alternate IAF stakeholders not addressed in this thesis judge the quality of an IAF. Different positions within the firm may shape different judgments on IAF quality such as, between junior internal auditors and the head/partner, or between auditees and senior management. These perceptions may be important to understand as the junior auditors and the auditees are likely to have more contact throughout the audit than the senior management and head/partner have.

IAF quality research identifies that an external auditors' reliance on the IAF is affected by the sourcing arrangement of the IAF. External auditors assess the quality of in-house IAFs differently to outsourced IAFs, as they judge outsourced providers to be more objective (Glover et al., 2008). The findings in this study suggest senior management may be more aligned with outsourced providers based on the theoretical predictions of resource dependency theory. Managerial literature also suggests management has a greater preference for externally sourced information (Menon and Pfeffer, 2003). An area for researchers to consider is whether there are differences in IAF quality judgments by audit committees and management, based on the sourcing arrangement of the IAF.

The participants identified the closeout of an audit engagement as a key determinant of IAF quality. The AC group require that any disagreements be resolved before the issue is brought to an audit committee meeting. Therefore, there is likely to be substantial negotiation between the IAF and management. Future research can draw on the extensive negotiation literature from external audit (Gibbins et al., 2001; Hatfield et al., 2008; Hatfield et al., 2010) to hypothesise the key factors that will influence the outputs and negotiation process between the IAF and management.

This thesis finds that the use of an IAF as a MTG is seen as a positive factor for IAF quality. In contrast, Messier et al. (2011) find external auditors are less likely to rely on the work of an IAF when the IAF is used as a MTG, as they perceive auditors to be less objective, thus of lower quality. As the use of the IAF as a MTG is a common practice (Abbott et al., 2010), the different finding of this study and Messier et al. (2011) is an interesting area for future investigation to determine if the differences are due to alternate IAF stakeholder perceptions or other differences.

While this study identified important factors as determinants of IAF quality, the thesis did not investigate if these factors differ for different engagements. For example, do these factors change for the type of activity performed, such as assurance versus consulting, or even within different types of assurance engagements? Further, Abdolmohammadi (2012) finds technical skills are the most important attribute for junior auditors, but less important as they increase in seniority, as perceived by CAEs. Future research can examine if other IAF stakeholders consider different attribute factors more important for different engagements or internal auditors?

Future research may also consider the inter-temporal dimension to IAF quality to provide a more complete understanding of the construct. For example, evidence from this thesis suggests management and the audit committee make judgments of IAF

quality over multiple internal audit engagements, and some management appeared to be influenced in their judgement of IAF quality by their previous experiences with the IAF. Future research can explore if IAF stakeholders' initial opinions or beliefs influence their assessment of IAF quality as shown to occur for assessments in external audit settings (Tan and Shankar, 2010) and psychology (Edwards and Smith, 1996).

6.5 CONCLUSION

In summary, this thesis investigated the concept of IAF quality, via interviews with experienced audit committee members and chairs, senior management, heads of in-house IAFs, and partners of internal audit divisions from major accounting firms. Establishing that our present understanding of IAF quality is limited to a single stakeholder, this thesis developed an IAF quality framework based on an interdisciplinary review of literature with models and frameworks for quality of services and tasks. It was found that the different governance stakeholders use different information cues to judge IAF quality. These information cues are based on the process, output and outcome dimensions within the IAF quality framework. Further, many factors are considered to be important determinants of the quality of an IAF beyond the input factors currently established in the literature. As such, IAF quality is found to be complex, multi-dimensional and stakeholder dependant.

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Appendices

APPENDIX A: IAF QUALITY RESEARCH

This section reviews the literature related to IAF quality with emphasis on how prior research has operationalized IAF quality. The review is divided into two parts, early research that was incorporated into Gramling et al.'s (2004) review and research conducted after Gramling et al.'s review. Following Gramling et al. (2004), literature on the external auditor reliance decision is classified as IAF quality literature, as external auditors must assess IAF quality in order to rely on IAF work. Further, studies have found IAF quality assessments and reliance decisions to be consistent, that is, the type of decision has been found to yield the same results (Schneider, 1985b).

Early IAF Quality Research

Early studies investigating IAF quality were based on external auditors' evaluation of quality and reliance on the work from the IAF (for example Brown, 1983; Brown and Karan, 1986; Edge and Farley, 1991; Maletta, 1993; Margheim, 1986; Messier and Schneider, 1988; Schneider, 1984, 1985a, 1985b).⁴⁶ These studies primarily focused on the relative importance of the 'three factors' of reliance prescribed by external audit standards (competence, objectivity and work performance),⁴⁷ attempting to decipher the most important factor external auditors' consider when evaluating IAF quality.

⁴⁶ Only studies that included at least two of the three factors (generally competence and objectivity) were included in this review. Studies that only looked at one factor were omitted, for example Clark et al. (1981) who only looked at objectivity.

⁴⁷ The majority of these studies used SAS 9 (1975), the current audit standard at the time, or the updated standard SAS 65 (1990). Edge and Farley (1991) used the Australian equivalent AUP 2 (1983).

This literature had mixed and inconclusive results regarding the importance of the ‘three factors’. The most common finding was that competence and work performance were considered of greatest importance to the external auditor, followed by objectivity. That is, either competence (Edge and Farley, 1991; Maletta, 1993; Messier and Schneider, 1988) or work performance (Brown, 1983; Brown and Karan, 1986; Margheim, 1986; Schneider, 1984, 1985b) were considered most important with the other factor second (or equal as found by Schneider (1985b)), and the least important was objectivity.⁴⁸ However, Abdel-Khalik et al. (1983) found objectivity the dominant factor and Brown (1983) found that objectivity was more important than competence.

Krishnamoorthy (2001, 2002) suggested the inconclusive results may suggest that the quality of, and the reliance on, the IAF is more complex than researchers had identified. In fact, Brown (1983), Messier and Schneider (1988) and Brown and Karan (1986) found that isolating and distinguishing between the ‘three factors’ was difficult for their experiment participants, which generalises that external auditors in practice would also have difficulties discerning the factors in their assessment.⁴⁹ Krishnamoorthy (2002) notes “it is futile to attempt a ranking of the factors since no single factor will dominate under all conditions” as the inferential value of the important factor may decrease if the other factors are unsatisfactory. He concludes therefore, reliability is contingent on the relationship between the three factors and as such, no single factor should be regarded as more important than another factor.

Gramling et al. (2004), in their comprehensive review of the IAF quality literature, conclude that studies of IAF quality are dominated by the viewpoint of the

⁴⁸ As noted by Krishnamoorthy (2002), the studies finding competence to be most important are more recent than studies finding work performance most important.

⁴⁹ Brown and Karan (1986) suggest there is an overlap between the factor’s competence and work performance and as such partially capture the same concept.

external auditor. One study, Lampe and Sutton (1994), not included in Gramling et al.'s review, compared internal auditor views of quality determinants with the external audit standards' proposed factors. Internal auditors agreed with external audit standards that scope, technical competence and objectivity are important, but aspects such as education level and professional certification were not. Internal auditors also considered some factors critical in quality assessment that are not included in external audit standards, including factors under planning, fieldwork and reporting (such as time spent on audit assignments, the internal audit manager's involvement in audits and understanding risks, and the reporting phase) (Lampe and Sutton, 1994).

Current IAF Quality Research

Current research on IAF quality can be divided into two categories: a) studies linking IAF quality to an actual firm outcome (such as reduced earnings management and accounting risks); and b) IAF quality and the external auditors' reliance decision to use the work of the IAF. Studies are reviewed below under these two categories.

IAF quality and firm outcomes

Prawitt et al. (2009) test the relationship between quality of the IAF and earnings management. Producing a composite measure of IAF quality based on six indicators from external audit standards which included experience, certification, training, objectivity, focus on financial work and firm investment in internal audit, they find earnings management is moderated by greater IAF quality. They measured IAF quality using a summation of dichotomous variables for above (1) or below (0) the sample median for each of the above six factors.

Measuring whether accounting risk is influenced by the internal audit sourcing arrangement (in-house versus outsourced), Prawitt et al. (2012) use IAF quality as one

of five factors to examine a firm's choice to outsource the IAF to their external auditor (using pre-SOX data). They find that high quality IAFs are associated with lower accounting risk (misleading or fraudulent financial reporting), regardless of the sourcing arrangement. Their IAF quality measure is the composite measure developed by Prawitt et al. (2009).

Lin et al. (2011), investigating the relationship between IAF quality and the existence of material weaknesses find the likelihood of detecting and disclosing material weaknesses increases with greater IAF quality. Their measure of IAF quality draws on Prawitt et al.'s. (2009) measure, and professional internal and external audit standards. Their measure includes competence, objectivity, relative investment in the IAF and the nature and scope of the IAF. They derived scores for these factors using summation and averages for internal auditor attributes and a dichotomous variable for the existence/non-existence of IAF activities.

Kaplan and Schulz (2007) formulated an experiment to test whether intentions of employees to use the IAF as a miscellaneous reporting (whistle blowing) channel is influenced by the quality of the IAF. They do not find a relationship between IAF quality and the intention to report to the IAF. Their measure of IAF quality was manipulated between participants and included variables based on prior IAF quality research. These variables included internal audit reporting lines, nature of IAF activities, certification of the internal auditor, budget of the IAF, and whether the IAF shared in performance bonuses.

IAF quality and the external audit reliance decision

Messier et al. (2011) examine if using the IAF as a management training ground (MTG) effects the external auditor reliance decision. In an archival examination, they find external audit fees are significantly higher for client firms where the IAF is used as

a MTG. To control for differences in quality across IAFs, IAF quality was measured via the composite measure developed by Prawitt et al. (2009). To help explain the results of this study, the authors conducted an experiment manipulating various MTG conditions and asked participants to evaluate statements on the three external audit standard factors (objectivity, competence, and professional due care)⁵⁰ on an 11 point scale (strongly disagree – strongly agree). They find external auditor reliance is affected by IAF quality as the external auditor perceives impaired objectivity for internal auditors in IAFs used as MTGs. An internal auditor's competence and due care are not perceived to be affected.

Felix et al. (2001) investigate four factors potentially affecting an IAF's contribution to the external audit and the relationship of IAF contribution to external audit fees. The four factors are the availability of internal audit, internal audit quality, coordination between the IAF and external audit, and the level of risk in the audit. Of the four factors, they find internal audit quality to be the greatest determinant in IAF contribution to the external audit. Further, findings indicate external auditor reliance is positively associated to IAF quality regardless of inherent risk and IAF contribution significantly affects external audit fees. Felix et al. (2005) examine if client pressure and nonaudit service (NAS) fees influence the external auditor reliance decision. They find that IAF quality affects the external auditor reliance decision when NAS are not provided to the audit client, but is not significant when NAS are provided, as client pressure outweighs the quality of the IAF when external auditors make their reliance decision. Krishnamoorthy and Maletta (2008) examine whether external auditor assessments of IAF quality are influenced by governance strength and audit committee

⁵⁰ The factors employed by Messier et al. (2011) are based on international external auditing standards, so the factor 'due care' is different to the 'three factors' discussed in this thesis.

expertise. They find both factors do influence the external auditor reliance decision. Each of these three studies measures external auditor assessment of IAF quality via a survey question where a subjective assessment of quality was scored on a 0 (very low) – 100 (very high) scale.

Desai et al. (2011) explore whether IAF sourcing arrangements (in-house; co-sourced; outsourced) affect an external auditor's decision of IAF quality and resulting reliance. Their findings suggest external auditors view IAF quality higher for co-sourced and outsourced functions. They also find IAF quality only affects reliance for high risk areas of the external audit (this finding differs to Felix et al.'s (2001) findings). Their measure of IAF quality consisted of external auditor's subjective ratings of the factors competence, objectivity and technical skills (0 (very low) – 10 (very high)).

Glover et al. (2008) also studied whether the IAF sourcing arrangement affected the external auditor reliance decision. Whilst they held objectivity and competence constant in their experiment, they measured external auditor perception of these two factors on a 0 – 10 scale (low to high) to establish whether other factors influenced an external auditor's reliance decision. They find internal auditor competence is not perceived differently for in-house or outsourced functions, but there is a significant difference for assessments of objectivity. Hence, they conclude that sourcing arrangement provides greater explanatory power in external auditor reliance decisions, beyond the factors of objectivity and competence, and is therefore an important factor in reliance decisions.

Pizzini et al. (2012) investigate whether IAF quality, and an external auditor's reliance on the IAF, affects audit delays. Their IAF quality measure is based on Lin et al.'s (2011) measure, however they expanded the nature and work performed factor to include quality of IAF fieldwork. They find that greater IAF quality lowers control risk

and as such reduces external auditor effort (as IAF quality increases external auditor reliance); therefore, IAF quality can reduce audit delay.

Desai et al. (2010) developed an analytical model of the decision process for external auditor assessment of IAF quality advancing previous studies by modelling the interrelationships, and the ‘And’ relationship, between the ‘three factors’ prescribed by the external audit standards. They further highlight the importance of corporate governance quality to IAF quality by incorporating corporate governance into their model and suggesting corporate governance quality is an important factor in external auditor assessment and reliance decisions.

Subsequent IAF research has extended the focus of the external auditor reliance decision by introducing contextual factors (or interacting effects), and whether these contextual factors affect the normal reliance decision. Maletta (1993) suggests that external auditors use more complex decision processes related to the ‘three factors’ (objectivity, competence, work performance) when an interacting effect is apparent. Research also finds that the external auditor decision to rely on the IAF is affected by: the sourcing arrangement of internal audit (Brandon, 2010; Desai et al., 2010; Glover et al., 2008; Munro and Stewart, 2010); internal audit involvement in consulting (Brandon, 2010; Munro and Stewart, 2010);⁵¹ the use of the IAF as a MTG (Messier et al., 2011); client pressure (Felix et al., 2005); client fee pressure (Gramling, 1999); nonaudit services (Desai et al., 2010; Felix et al., 2005); inherent risk (Glover et al., 2008; Maletta, 1993; Maletta and Kida, 1993); subjectivity of the task performed (DeZoort et al., 2001; Glover et al., 2008); firm culture (Krishnamoorthy and Maletta, 2008; Lampe and Sutton, 1994; Margheim and Label, 1990); audit committee quality (Cohen et al.,

⁵¹ In contrast, DeZoort et al. (2001) find that IAF consulting has no effect on external auditor reliance on the IAF.

2007a; Krishnamoorthy and Maletta, 2008);⁵² audit committee interaction and oversight (Abbott et al., 2012; Felix et al., 2001; Gramling et al., 2004) and internal auditor compensation (Chen et al., 2009; Dezoort et al., 2001). These contextual factors are outside the direct control of the IAF.

Two other recent studies address IAF quality and/or the reliance on the IAF. However, these studies do not measure IAF quality. Anderson et al. (2012b) identify four measures of IAF quality they perceive will signal a greater commitment to IAF quality by the organisation and therefore have an impact on the size of the IAF. These four measures are: the internal auditor is IIA certified; experience as an internal auditor; the chief audit executive's experience in the organisation; and the IAF's use of sophisticated audit tools. The second study, conducted by Burton et al. (2012), investigates corporate management's reliance on the IAF under certain conditions of IAF reporting. It is important to note that this study did not measure corporate managers' reliance on the IAF via an assessment of IAF quality, but how characteristics of IAF reporting affected corporate managers' reliance on IAF recommendations. They find managers are more likely to rely on information from in-house IAFs (than outsourced) if the information is preference-inconsistent and quantified, but find no difference in reliance levels of in-house or outsourced IAFs when information is preference-inconsistent but not quantified.

⁵² Audit committee quality can affect reliance directly by affecting an internal auditor's judgments (such as on fraud risk assessments) (Asare et al., 2008), and indirectly as audit committee expertise is negatively associated with internal control problems (Hoitash et al., 2009; Naiker and Sharma, 2009).

APPENDIX B: IAF QUALITY AND EXTERNAL AUDIT STANDARDS

External audit standards encourage the external auditor to use the work of the IAF in the external audit. To rely on internal auditor work, the external auditor must exercise professional judgment in assessing internal auditor quality including internal auditor competence and objectivity and that the nature and scope of the work performed by the IAF is relevant to financial reporting and financial statement audits (AICPA 1990; PCAOB 2007; IFAC 2009c). This is collectively known as the external auditor ‘reliance decision’ and these factors are the factors referred to in this thesis as the ‘three factors’ of the external auditor reliance decision. Under international standards, the external auditor must also assess that internal audit work has been carried out with professional due care and there is effective communication between the external and internal auditors (IFAC 2009c).⁵³

Table 9 summarises the factors to be considered in assessing IAF quality outlined in various external audit standards. This thesis uses the ‘three factors’ outlined in the AICPA and PCAOB standards in discussion of the ‘three factors’ of the external auditor reliance decision, as the vast majority of quality measures in prior studies have been based on these standards as a result of being U.S. based data and research. The table also includes the revised international external audit standards which came into effect at the beginning of 2013. The discussion on international external audit standards in this thesis has been on the 2009 standards as these were the current standards at the time of data collection and are consistent with recent IAF quality research.

⁵³ A revised international audit standard, ISA610 (IFAC 2012) takes effect for audits for the period ending on or after 15 Dec 2013. This revised standard has replaced the requirement to assess internal auditor due care and the effective communication between the auditors, with an assessment that internal audit work is carried out with the application of a systematic and disciplined approach.

Table 9: Factors of IAF Quality within Various External Audit Standards

AICPA SAS No. 65 (1991)	PCAOB AS5 (2007)	IFAC ISA 610 (2009c)	IFAC ISA 610 Revised (2012)
Competence	Competence	Competence	Competence
Objectivity	Objectivity	Objectivity	Objectivity
Work performance	Work performance	Professional due care Effective communication	Application of a systematic & disciplined approach

External audit standards include more components under the ‘three factors’ than research measures of IAF quality have included. For example, competence includes components such as working paper documentation and supervision, and objectivity includes policies on maintaining objectivity. Due to restrictions in availability of this type of data, research has been unable to include these components in measures (Prawitt et al., 2009). Finally, external auditors, when using work already performed by the IAF are required to perform sufficient audit tests to ensure that the work of the IAF is appropriate. This form of consensus on outputs can be considered an ex-post examination of output quality. IAF quality studies have not captured this aspect.

APPENDIX C: IIA STANDARDS AND QUALITY GUIDANCE

The IIA suggest quality internal audits are achieved through meeting stakeholder expectations and conformance to the IIA standards (International Standards for the Professional Practice of Internal Auditing) and the IIA Code of Ethics (IIA 2010).⁵⁴ IIA standards contain attribute and performance standards (IIA 2009). Attribute standards address attributes of the individual auditor and the department and are similar to the ‘three factors’ prescribed by external audit standards. The attribute standards include independence and objectivity, proficiency (competence), professional due care and the quality assurance standards (quality assurance standards are discussed below). The performance standards are concerned with the nature of the IAF and performance quality criteria. Broadly, the performance standards include managing the internal audit activity, nature of work, engagement planning and performance, communication of results, and monitoring of progress.

Specific IIA standards pertaining to quality (as identified in the IIA’s Quality Assessment Manual (2011b, p. 8)) are the ‘1300’ standards. These seven standards are associated with the requirement of establishing and implementing a quality assurance program for the function. The purpose of this program is to assess an IAF’s conformance with IIA standards, the IIA’s definition of internal auditing and the application of the IIA’s code of ethics; the program also assesses IAF effectiveness and improvement opportunities (IIA 2009; IIA 2011b, p. 11). The program suggests an important aspect of quality assurance is stakeholders’ perceptions of IAF performance (IIA 2011b, p. 37). Two significant performance measurements for internal audit were

⁵⁴ The IIA suggest conformance to standards, the definition of internal auditing and the code of ethics is mandatory for all members under IIA by-laws (IIA 2011b, p. 7). However, unlike other accounting areas such as external auditing and financial statement reporting, conformance with IPPF standards is not a legal obligation.

suggested: the time between the completion of an audit and the issuance of the audit report; and, the percentage of IA recommendations accepted.

Overall, the IIA guidance on IAF quality is largely designed for the preparers of the service, the internal auditors. While IIA standards guide the IAF, they do not provide overt direction on how to assess IAF quality, particularly for stakeholders outside the function. In fact, IIA guidance on IAF quality is a rather cyclical process. The IIA contend IAF quality involves conformance to IIA standards; the IIA standards pertaining to quality require a quality assurance program; and the quality assurance program assesses whether an IAF conforms with IIA standards. However, there are two identifications within IIA prescriptions that are not part of this cyclical process. First, that part of IAF quality is meeting stakeholder needs, and second, the quality assurance program assesses IAF effectiveness.

APPENDIX D: FOCUS GROUP

A focus group is a method whereby a researcher (facilitator) focuses discussion by participants on a pre-specified topic with open ended questions (Eriksson and Kovalainen, 2008, p. 173; Sutton and Arnold, 2013). The objective is to acquire data by having participants discuss personal viewpoints on the topic, but also to interact and build on others' responses (Sutton and Arnold, 2013). Advantages of focus groups are that they are cost effective and useful when access to participants is limited, the interactions between participants can enhance the quality of data, and it is easy to discern between shared and opposing views. Limitations include the confidentiality of responses cannot be assured, bias may be introduced as minority views may not be revealed, and time constraints (Dossi and Patelli, 2008; Patton, 2002, pp. 386-387; Sutton and Arnold, 2013). The use of a focus group prior to field interviews can help the researcher to clarify issues and themes for the structure and content of interviews (Silverman, 2010, p. 197).

The focus group was conducted in January 2012, at the Sydney office of the IIA. The focus group comprised four internal audit managers from Australian publicly listed firms and one independent internal audit consultant who works with both private and public sector organisations. Participants were organised by invitation sent from the IIA. The focus group ran for 1 hour (10-15 minutes of which was spent on this topic). The below questions were asked in the latter stages of the focus group, at which stage strong rapport had already been established, both between the researchers and participants and between the participants themselves. The participants were candid and freely provided their insights.

Participants were asked the following two broad questions and they answered freely without any prompting or leading from the researchers present:

1. Who in the organisation assesses the quality of internal audit?
2. What factors are these [people/groups identified] looking at when assessing IAF quality?

The focus group was not recorded. The researcher and one research assistant took notes of the discussion, and detailed notes were made at the conclusion of the focus group. The discussion provided insights that supported this thesis' theoretical framework and insights into key stakeholders to be included in the research. Results also gave the researcher confidence that the research questions were pertinent, and provided practical insight to aid development of the questions in the interview guide. Even with these interesting findings, the data was not analysed as part of the main results; this was because this method was used in an exploratory purpose and in focus groups, participants responses are influenced by others' responses.

Discussion on the first question about who in the organisation assessed the quality of the IAF identified five people/groups. Four of the five identified were included as the internal governance stakeholders identified in Cohen et al.'s (2004) model (Figure 1). Those people/groups identified included the senior executive team, the head or manager of the IAF, the audit committee, the external auditor and divisional management. One participant summarised and stated that almost everyone in the organisation is a stakeholder of the IAF and therefore they would likely be assessing the quality of the IAF to a degree. Another participant suggested that divisional management is represented by the senior executives. The groups identified as those who assess IAF quality in this focus group, and this previous comment on divisional management,

provided support for the decision to include the audit committee, senior management and internal auditors as participants for this research.

The discussion morphed to the importance of the stakeholders assessing the quality of the IAF. That is, which stakeholder's assessment of IAF quality were the most important. Participants reasoned between the audit committee, senior executives and divisional management. It was also argued that the IAF manager/head's assessment was of very high importance as the person in charge of the IAF should not release reports or findings if they contemplated that the IAF had performed the audit "under-par". While focus group participants considered external auditors placed heavy reliance on the IAF and therefore make assessments on IAF quality, they were not considered as the most important stakeholder who made an assessment of IAF quality. For example, one participant stated the external auditors placed major reliance on his/her IAF, but his/her IAF does not operate for the external auditor, simply the external auditor relies on the work performed by the IAF. Whilst the importance of the stakeholders assessing IAF quality was not a question posed in the focus group, the insights from this discussion again supported the decision of participants chosen for this thesis.

The second question addressed what these identified stakeholders would look at to assess IAF quality. However, the direction of the discussion on this question largely revolved around what the head of the internal audit department would look at to assess IAF quality. The quality identifiers are presented in the order they were discussed in the focus group. First was a review process by the team leader/manager of the internal audit that would then be reviewed by the head of internal audit. These reviews covered the entire IAF from initial planning to final output. Second was the reports produced by the IAF. All participants agreed that the reports were important in the assessment of quality. One participant identified that the general manager of the IAF (the person in charge of

oversight of the IAF head) looked at the number of iterations the internal audit report had been through, suggesting that report iterations were used as a rule of thumb for assessing quality in his/her organisation. Third, the people involved in the internal audit (the internal auditors) were likely to be assessed. This included their expertise in the area under review such as their knowledge and experience in the area. Fourth, a participant stated that their organisation brought in an expert in the area to verify the output of the internal audit. That is, the expert would be used to see if they (the expert) would have come up with the same output from the information available. Another participant suggested their IAF used a subject matter expert to also help them set the plan as well as check over the 'answers' the IAF came up with. This participant considered the use of the expert to be very beneficial and improved the quality of their audits. Fifth, the use of the IIA's quality assurance program was identified as a great way for a third party to assess the quality of the IAF. Lastly, a participant identified that the value-added from the audit provided a good indication of quality. This participant suggested that quality comes from working out what the client (in this case the audit committee) expectations are and prioritising these needs. A limitation of this focus group was that participants only discussed how the head of the IAF assesses the quality of the IAF and not that of other stakeholders. Time constraints limited the researcher from probing further about other participants. Nevertheless, the discussion identified that there are a range of factors that a head, or manager, of an IAF would assess. These included the internal auditors (inputs), reports (outputs) and value (outcomes) which supported the proposed theoretical framework developed as part of this research.

APPENDIX E: INTERVIEW GUIDE

As stated in Section 3.4.2, the interview guide was customised for each group of participants to cater for variation in positions. The interview guide presented below is customised for audit committee participants. Presented below are questions pertinent to this thesis.

Background Questions:

- Participants current and previous experience
- Confirm participant's association and experience with the IAF
- Confirm sourcing arrangement of the IAF
- How many staff are in the IAF at Organisation XYZ?
- How many years has an IAF been in existence in Organisation XYZ?

Key Questions:

Q1

I would like you to think of an internal audit engagement you have been associated with that you perceived to be of high quality or was of lower quality.

Based on your experience as an audit committee member/chair how did you perceive the quality of this engagement?

Probe: What in particular indicated to you this engagement was of high (lower) quality?

Q2

You have just discussed an example of a *high (lower)* quality internal audit engagement. Now I would like you to think about a *lower (high)* quality engagement you have been associated with.

Based on your experience as an audit committee member/chair how did you perceive the quality of this engagement?

Probe: What in particular indicated to you this engagement was of high (lower) quality?

Q3

If possible, I'd like you to compare the IAF of Organisation XYZ to the IAF of another company where you are, or previously were, a member of the audit committee.

In regard to the quality of the IAF, what are the major differences between these two IAFs?

The following are probes for questions 1 to 3 when necessary:

- a) In your experience, how often does this occur?
- b) Can you discuss a time when you were unable to rely on the work of the IAF
- c) In your experience, have you served on a committee that has changed the IAF provider, or changed from an internal (external) to external (internal) sourcing arrangement?

What were the key reasons behind this decision of the audit committee?

- d) Are there any specific engagements where quality is more important or quality dimensions differ?

Q4

As an audit committee member how do you ensure or oversee the IAF is of high quality?

Follow-up questions related to interview questions 1 to 2. These follow-up questions were asked after question 4 to avoid biasing responses:

Many participants responded to questions 1 and 2 with experiences of very specific engagements. Others responded briefly with their experience and then discussed IAF quality more collectively as a group of engagements. Below are probe questions used to have participants discuss quality broader (asked after it was established how the participant judged IAF quality):

- a) In these examples, you have discussed many internal auditor attributes. Are these the attributes necessary for high quality internal audit?
- b) In conducting an IAF, what is necessary for high quality internal audit?
- c) How do you get acquainted with the IAF to assess their quality or quality of the audit process

- d) In these examples, you have discussed the outputs of the IAF presented to you.
What features of outputs indicate to you high quality internal audit?
- e) Is there anything outside of IAF's control that impact their quality?

Other questions asked towards the end of the interview not analysed in the thesis:

STAKEHOLDERS

Now I would like to discuss other stakeholders or clients of the IAF.

- Who else in the business relies on the internal audit?
- From your experience, who would you say is internal audits most important stakeholder/client?
- And from your experience, does the IAF treat this stakeholder/client as their most important?
- Thinking about the examples of high and lower quality internal audits you discussed earlier, how do you perceive these stakeholders assessed the quality of that engagement?
- Again, on these examples, how do you perceive the head/partner of the IAF assessed the quality of that engagement?
- Overall, what do you think management consider being important attributes of quality?
- Overall, what do you think the head/partner of the IAF considers being important attributes of quality?
- When do you discuss with [management/Internal Audit/External auditor] the quality of the IAF?
- When you discuss the quality of an IAF with [management/Internal Audit/External auditor], are your views similar?

VALUE

- How does a high quality IAF add value to your position

Concluding Questions

Is there anything that you would like to add or you feel we didn't cover about internal audit quality?

APPENDIX F: CODE BOOK

Factor	Code	Description
Inputs	That which exists going into the audit: the internal auditor(s) themselves and the internal audit department	
Internal auditor general overview	IAG	Nonspecific input category – for use when statement is too broad to code in the below input categories. Such as right people/wrong people used;
Internal Auditor Skills/Competence	IAS	The soft and hard skills and the competence the internal auditor(s) have; skills including: technical; relationship; communication; leadership; analytical; problem solving; project management; specialist
		Soft - the internal auditors skills relating to relationship, communication, leadership etc.
		Hard/Competencies - the internal auditor technical skills (such as accounting, analytical etc.) and professional qualifications
Internal Auditor Personal Attributes/Personality	IAP	The character of the internal auditor, including confidence; ability to stand-up for themselves; strong-willed; driven
Internal Auditor Experience	IAE	The internal auditors experience within this particular: role (as internal auditor); business; industry. Experience as a contributor to quality
Internal Auditor Training	IAT	Present Training internal auditors are subject to, to improve their abilities (e.g. courses, development programs, study); past training would be included as a skill
Internal Auditor Independence/Objectivity	IAO	The independence or objectivity of the auditor
Lines of Communication	IAL	The internal audit reports to a 'level' within the business and has access to 'levels' within the business (Levels: Audit committee; CEO; CFO; Line Managers) (Functional; Administrative; Dotted Line)
Internal Audit Department	IAD	A generalised category for the internal audit Department; including: funding, resources, access to tools; adequate time and staffing, audit plan and charter
Processes	The actions/activities that internal audit does to produce something	
Process General overview	PG	Nonspecific category: used where the below categories are lumped together and cannot be separated (i.e. all in 1-2 quick sentences)
Scope of the audit	PS	The range/extent of internal audit activities
Methodology of the audit	PM	The general audit process; analysis of data; documentation of evidence; use of manuals/or templates

Factor	Code	Description
Adherence to the audit plan	PAP	Audit plan - adhering to, following, changing, development, stakeholder involvement in setting
Relationships	PR	Internal auditors relationship with the clients they are auditing and others in the business; including developing and maintaining relationships
Understanding of the business to align the audit with objectives	PU	Understanding the business, a holistic view of the outcome to the organisation: (includes: the auditor can see past the audit plan and go further/deeper if needed)
Standards	PStan	Use and/or conformance of Internal auditing standards in the conduction of an audit/s
Audit closeout	OF	What occurs with internal audit findings before a report is produced; e.g. IAF meetings with management to discuss findings; develop management action plans; rate the severity of findings
Monitoring of quality	PQM	Internal audits use of any method to assess the quality of their function (e.g. surveys, talking to stakeholders/clients; quality reviews)
Outputs/Outcomes		Result of the processes - that which is produced by the audit
Outcomes	OO	The outcomes of the audit work produced; the consequence of the audit findings, the resulting change and value for the business, the effect on the business
Reports	OR	Overall general reporting of the Internal audit - e.g. timely; clear; concise, appropriate; recommendations
Presentation of findings	OP	IAF presents findings to audit committee and/or senior executives
Findings and recommendations	OF	the quality of the findings and recommendations from the audit
Managements response to Internal audit Findings	OMR	Managements response to the actions/recommendations proposed by internal audit reports; management action audit findings and recommendations
Value Adding		How a quality IAF adds value overall to the business and individuals
To the business	VAB	The value internal audit adds to the business
To their position	VAP	The value internal audit adds to a role/position (e.g. CEO; audit committee); that is, the specific clients
Stakeholders (clients)		The clients/users of the internal audit function - those who are being audited and those who receive the internal audit output
Other Stakeholders	SO	Who they perceive as the/the other stakeholders of internal audit
Relationships	SR	The strength or quality of the relationships between the internal auditor and the stakeholders/clients

Factor	Code	Description
Stakeholder expectations	SE	Expectations of the interviewee (when management or AC) and their perception of other stakeholder's expectations from internal audit and in regards to high internal audit quality
Stakeholders quality	SQ	Interviewees interpretation of how other stakeholders would view/judge/assess internal audit quality
Stakeholder involvement	SI	Level of involvement in internal audit by the stakeholders (so their input into the audit) and between the stakeholders and the internal audit
Oversee Quality		
Stakeholder contribute to the quality of the IAF	SC	How does the interviewee oversee or help contribute to high internal audit quality
IAF provider oversight of the IAF	SP	How the head of internal audit manages the audit/department effectively to create quality
Contextual Factors		Factors outside the control of internal audit that can impact on the quality of internal audit
Culture/ Organisation's philosophy to internal audit	FOC	Culture of (or within) the firm that can impact the quality of internal audit; includes the internal audits status/position/respect within the firm
Individual impacts	FOI	Individuals within the firm that impact the quality of internal audit
Environmental impacts	FOE	Factors outside (external to) the firm that impact the quality of internal audit; e.g. industry, market, regulatory
Consulting		
Internal audit and their consulting role	CO	Internal audits role in consulting to the firm and as part of a quality IAF (e.g. advisory and related client service activities - including advice, facilitation, counsel and training)
Difference of Sourcing		The effect of the way internal audit is sourced: in house department; outsourced to a firm/provider; co-sourced
Changes in the way IA was sourced	DC	Interviewees specific experience when their firm changed from one type of sourced internal audit to another
Positives/negatives of a type of sourcing arrangement	DPN	Positives or negatives of a particular type of sourcing of the internal audit: (benefit or detriments to the audit/value to the business)
Management training ground		
IAF used as a management training ground	MTG	IAF is used as a platform to train people for future business roles or to bring people from the business into internal audit - Secondment; transition to the business; development centre

Factor	Code	Description
General	A category to capture elements of the interview that do not fit in the above categories	
General internal audit quality	GQ	An element or overview of internal audit quality that does not fit in a category above
Internal audit general	GIA	An element or overview about internal audit that is not directly related to internal audit quality (i.e. other internal audit matters)
Judgment	J	Part of participant judgment of IAF quality
Factor of IAF quality	FQ	Participant view as a determinant factor to IAF quality