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: __________________________
Acknowledgments

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