Factors Affecting Internal Auditors' Ethical Decision Making: Other Corporate Governance Mechanisms and Years of Experience

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Published

2006

Conference Title

Fifth biennial One-Day Symposium on Accountability, Governance and Performance

Version

Accepted Manuscript (AM)

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Abstract: This paper explores the ethical reasoning of internal auditors and examines the impact of other corporate governance mechanisms on their ethical sensitivity and judgments. We also explore whether ethical reasoning is influenced by years of experience in internal auditing. Sixty-five internal auditors were presented with five ethical dilemma scenarios. Five corporate governance variables were manipulated. These were, audit committee support; management integrity as regards accounting policies; management integrity as regards pressure on internal audit; external auditor characteristics; and organisational code of conduct. The results indicate that the characteristics of the external auditors appear to impact internal auditors' ethical decision making. However, we do not obtain significant results for the other four variables. We also find that years of experience has some influence on ethical reasoning.

Key Words: internal audit; ethics; corporate governance

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Introduction

The ethical standing of any profession is critical to its acceptance in society (Mintz, 1995). Armstrong (1993, p.38) considers ethical conduct to lie "at the core of each profession's reason for existence". This is particularly so for the accountancy profession where ethical failings can have far-reaching economic impacts and cause widespread financial distress.[1] Procedures such as the issuing of the Joint Code of Professional Conduct (Institute of Chartered Accountants in Australia (ICAA) and CPA Australia, (ICAA, 2004), the setting up of disciplinary committees, and the imposition of professional sanctions are steps the profession takes to encourage members to act, and be seen to act, in the public interest.

A branch of the accountancy profession that has strived for professional status in its own right is internal audit (Ridley, 2004). Like other branches of the profession, The Institute of Internal Auditors (IIA) has a code of ethics which is designed to promote an ethical culture within internal auditing (IIA, 2000). The code sets out the principles governing integrity, objectivity, confidentiality and competency, together with rules of conduct with respect to these principles.

Ethical principles are particularly important for internal auditors for two reasons. First, internal auditors are frequently faced with ethical dilemmas which can challenge their standards (Larkin, 2000; Goodwin and Yeo, 2001; Thompson, 2003). They may face situations which require them to speak out (Barrier, 2003) and this is not always easy, particularly when pressure is being exerted by senior management to "go with the flow" and not to "make waves" (Thompson, 2003, p.72). Second, with the current emphasis on corporate governance, it is becoming increasingly recognized that internal auditors can play a key role in strengthening business ethics and corporate integrity (Brown et al., 2003; Jennings, 2003; Moeller, 2004). As one of the cornerstones of corporate governance, internal auditors are expected to work with audit committees, boards and senior management to help set the right "tone at the top" and to help ensure that ethical behaviour flows down through the ranks to lower level employees (IIA, 2003; Brown et al., 2003; Bailey et al., 2003).

The objectives of the present study are to explore internal auditors' sensitivity to ethical dilemmas and to examine whether other key corporate governance mechanisms impact their ethical decision making. We also examine whether the level of experience of internal auditors affects their ethical judgments. Only a few studies have focused on the ethical judgments of internal auditors (Dittenhoffer and Klemm, 1983; Arnold and Ponemon, 1991; Dittenhoffer and Sennetti, 1994; Larkin, 2000) and none of these examines these issues in the context of the new role of internal audit as a key corporate governance mechanism.

We achieve the objectives of our study by presenting practising internal auditors with five ethical scenarios. For each scenario, we manipulated the strength of a key element of corporate governance in a between-subjects design. The manipulations include audit committee strength, two aspects of management integrity, commitment to a code of conduct, and external audit characteristics. Participants are asked to indicate the likelihood that the internal auditor in the scenario would behave in a certain manner and how ethical or otherwise that behaviour would be. These responses enable us to gauge whether the corporate governance mechanisms influence ethical decision making and whether the participants' level of experience impacts their judgments. Our findings suggest that the characteristics of the external auditors impact internal auditors' ethical decision making. However, we do not obtain significant results for the other corporate governance variables. We also find that years of experience has some influence on internal auditors' ethical judgments.

The remainder of the paper is structured as follows. The next section discusses prior literature and provides the background to the study. The third section outlines the research method while the fourth section reports the results of the study. The final section concludes by discussing the implications of the research findings, highlighting potential limitations and considering future areas for research.

Background and Research Questions

Prior Research on Accountants' Ethical Decision Making

A substantial body of literature has explored the ethical reasoning of accountants and external auditors, focusing on the impact of both individual and contextual factors (Jones et al., 2003). Individual factors examined include the level of ethical development[2] (Ponemon and Gabhart, 1993; Bernardi, 1994; Thorne, 2000), political orientation (Sweeney, 1995; Eynon et al., 1997), work experience (Bernardi, 1994; Thorne et al. 2003), organisational commitment (Patterson, 2001; Lord and DeZoort, 2001) and gender (Ponemon, 1992; Ponemon and Gabhart, 1993, Sweeney, 1995; Thorne and Magnan, 2000). Contextual factors include national culture (Karnes et al., 1990; Cohen et al., 1995a and 1995b; Tsui, 1996; Goodwin et al. 2000), regulatory environment (Patterson, 2001; Thorne et al., 2003) and ethical intensity of a dilemma (Shafer et al., 1999 and 2001). Studies have also examined the ethical reasoning of accountancy students (Cree and Baring, 1991; Haswell and Jubb, 1995; Goodwin and Goodwin, 1999; O'Leary and Cotter, 2000) and also compared students with practitioners (Armstrong, 1987; Ponemon and Glazer, 1990; Lampe and Finn, 1992; Shaub, 1994). To a varying extent, these studies support the notion that both individual and contextual factors influence accountants' and accounting students' ethical judgments.

In contrast, research into the ethical reasoning of internal auditors is sparse. Dittenhoffer and Klemm (1983) evaluated internal auditors' attitudes to twenty ethical issues, with the study being replicated ten years later by Dittenhoffer and Sennetti (1994). These researchers generally found an improvement in attitudes towards ethical issues over the ten year time period. Arnold and Ponemon (1991) examined internal auditors' perceptions of whistle-blowing, using Rest's (1979, 1994) DIT. They found that internal auditors with lower levels of moral reasoning were less likely to select whistle-blowing as a means of disclosing wrongdoing and this was particularly so when the whistle-blower was likely to lose their job. Larkin (2000) examined the effect of gender, age, years of employment and peer group influence on the ethical judgments of internal auditors working in a large financial services organization. He found a gender effect, indicating that females appear to identify ethical behaviour better than their male counterparts, and an experience effect, suggesting that more experienced internal auditors tend to be more conservative in their ethical judgments.

The present study extends prior studies in that it not only examines internal auditors' ethical reasoning, but also introduces a range of contextual factors specifically associated with the new role of internal audit as part of a broader governance framework. The study also examines years of experience in internal audit as an individual factor.

Corporate Governance

The contextual factors included in the study relate to other key corporate governance mechanisms. We manipulate the strength of the audit committee, the "tone at the top" set by senior management (as measured by their attitude to accounting policy changes and pressurising internal audit), commitment to a code of conduct and the characteristics of the external audit firm. The rationale for examining the impact of these factors on internal auditors' ethical decision making lies in recent suggestions that corporate governance is comprised of four cornerstones: the audit committee, management, external audit and internal audit (IIA, 2003; Gramling et al., 2004; Adamec et al., 2005). Hence, we explore whether aspects of the other cornerstones of governance assist internal auditors to act ethically.

The board of directors has been recognised as the key player in corporate governance by regulators and governance committees around the world (Cadbury Committee, 1992; United States (US) Congress, 2002; Australian Stock Exchange Corporate Governance Council, 2003). As a sub-committee of the board, the audit committee, in particular, plays an important role in enhancing the quality of financial reporting (Jiambalvo, 1996; McMullen and Raghunandan, 1996; Davidson et al., 2005). An effective audit committee should also strengthen the position of the internal audit function by providing an independent and supportive environment where the chief internal auditor (CIA) can raise matters affecting management (Braiotta, 1999; Goodwin and Yeo, 2001; Goodwin, 2004).

Executive management plays a vital role in corporate governance by ensuring that the appropriate systems of internal control and risk management are in place (COSO, 1992; Adamec et al., 2005). However, according to Cynthia Cooper (the former vice-president of Internal Audit at WorldCom Inc.), "it is the behavior of corporate leaders that has the greatest impact on an organization" (Barrier, 2003, p.54). This is particularly so with respect to establishing a strong ethical environment. While internal audit can assist management to instil a strong ethical tone throughout the organisation, a poor attitude by management can make it very difficult for the internal auditor to uphold ethical behaviour. This is evidenced by the problems associated with whistle-blowing, particularly when the internal auditor's job security or progress is threatened (Arnold and Ponemon, 1994).

Both directors and management can further strengthen the ethical environment within the organisation by developing and enforcing a robust code of ethical conduct (Barrier, 2003; Brown et al., 2003; Adamec et al., 2005). Research evidence suggests that corporate codes of ethics, accompanied by training and monitoring programs, have an impact on employee behaviour (Pickard, 1995). The Working Group on Corporate Practices and Conduct (1993) in Australia argues that a code of ethical conduct should help to maintain high standards of behaviour throughout the organisation. To be effective, however, the code must be communicated throughout the organisation and enforced by management (Brooks, 1992; McNamee, 1992; Goodwin and Seow, 2002).

External audit is also regarded as an important cornerstone of corporate governance, particularly with respect to the prevention and detection of fraud and errors in financial statements (Adamec et al., 2005; Davidson et al., 2005). External auditors play a valuable monitoring role in improving the credibility of financial reporting (Schelluch et al., 2004). The performance of a quality audit, however, is dependent on both the independence of the external auditor and on the nature and extent of the work undertaken (DeAngelo, 1981). The external auditor can rely on the work of internal audit provided certain conditions are met concerning the status, competency and scope of work of the internal audit function (IAS 610, IFAC 2004). In working together, the relationship between internal and external auditors should be one of mutual support and cooperation in order to strengthen overall audit quality (Green, 2003; Gramling and Myers, 2003).

Years of Experience

As noted, a number of prior studies have found that experience impacts on the ethical decision making of accountants and auditors. However, the direction of the relationship is ambiguous. In an experiment on working paper review, Bernardi (1994) found that managers outperformed seniors with respect to identifying ethical cues. Bernardi and Arnold (1997) found a positive association between years of work experience and moral development (measured by DIT scores), but only for female accountants. In contrast, Shaub (1994) reported a negative association between DIT scores and years of work experience. Ponemon and Gabhart (1993) obtained conflicting results between Canadian and US accountants. Years of experience were negatively related to DIT scores for US accountants but positively related with DIT scores for Canadian accountants. The findings of this study contrast with those of Thorne et al. (2003) who found a significant negative association between years of experience and DIT scores for both US and Canadian accountants. As previously discussed, the only study to examine the effect of experience on internal auditors' ethical decision making found that more experienced auditors made more conservative ethical judgments (Larkin, 2000).

Research Questions

The above discussions lead to the following research questions (RQ):

RQ1: To what extent do other corporate governance mechanisms affect internal auditors' ethical judgments?

RQ2: To what extent does experience in internal auditing affect internal auditors' ethical judgments?

Research Method

Sample and Procedures

The study was conducted as a field experiment. In March 2005, approximately 400 experienced internal auditors attended the SOPAC conference, the annual conference of the Institute of Internal Auditors (IIA) Australia, in Brisbane, Australia. They came from approximately six countries, predominantly Australia. With the support of the IIA, a survey instrument (discussed below) was distributed to approximately 250 of the delegates, at various sessions of the congress. Delegates were to return completed copies to the reception desk at the end of the conference or they could take the survey instrument away with them and complete it later. They were provided with a reply paid envelope to return the completed survey instruments to the researchers. A letter indicating the support of the IIA accompanied all copies of the survey instrument. A total of 66 completed surveys were returned to the researchers, representing a response rate of 26%.

Research Instrument

The research instrument comprised an introductory letter indicating the support of the IIA, a brief summary of the research together with instructions, five ethical dilemmas each followed by two questions, and a section concerning the background of the respondent. The background questions related to years of experience, gender, sector worked and nationality.

The two questions asked after each dilemma were based on prior ethical studies in accounting and auditing. The first question asked the respondent to assess the likelihood that the internal auditor in the scenario would act in a certain manner. A nine-point scale (ranging from 1 to 9) was provided with the endpoints marked as ‘highly unlikely’ and ‘highly likely’ respectively. The second question asked respondents to assume that the internal auditor had not taken the action suggested and to indicate how unethical or ethical they perceived the lack of action to be. Again, a nine-point scale was used, with the endpoints marked as ‘extremely unethical’ and ‘extremely ethical’ respectively. Following Ponemon and Gabhart (1990) and Arnold and Ponemon (1991), we developed scenarios in the third person rather than asking what the respondent would do. These authors suggest that, because of the sensitive nature of ethical issues, framing the questions in this manner provides a reliable measure of what the respondent actually believes.[3]

Two versions of each dilemma were developed, manipulating the background information of each scenario to capture the impact of other corporate governance mechanisms on internal auditors’ ethical decision making. As noted, these are the strength of the audit committee, management integrity (as evidenced by changes to accounting policies), management integrity (as evidenced by pressure exerted on the internal auditor), commitment to a code of ethical conduct, and characteristics of the external audit firm. Each factor was manipulated at two levels, stronger or weaker[4], as shown in Table I. Version One of the research instrument had two of the factors set at a strong level and three at a weak level (Scenarios One and Three were strong and Scenarios Two, Four and Five were weak). Version Two had three strong factors and two weak factors (Scenarios Two, Four and Five were strong, while Scenarios One and Three were weak). Hence, the strengths of the five scenarios were varied within each version of the research instrument. This was to avoid the respondents falling into a “pattern effect” due to reviewing all “good case” or “bad case” scenarios. A pilot study involving four experienced auditors resulted in a satisfactory assessment of both versions of the survey instrument, prior to its distribution for the actual study.

I provides brief details of the ethical dilemmas faced by the internal auditor, together with a summary of the manipulations of the corporate governance factor pertaining to each dilemma.

INSERT TABLE I ABOUT HERE

Results

The 66 responses received were analysed using the *SPSS* software package. As the two versions of the research instrument had been issued randomly, this resulted in 32 useable responses to version 1 and 34 useable responses to version 2.

A summary of the biographical data for the respondents is given in Table II. The table shows that 88% of respondents were male and 85% were from Australia. These distributions mean that we could not meaningfully test for gender or country effects. However, tests indicated that the omission of the females and non-Australians from the sample does not materially impact our results. Table II also shows that 71% of respondents work in the private sector and 29% in the public sector. We tested for the possibility of sector differences, with the results providing no evidence that the sector in which internal auditors work influences their ethical decision making.

INSERT TABLE II ABOUT HERE

It can also be seen from Table II that only 20% of respondents have less than five years experience in internal auditing, while 23% have twenty years or more experience. For the purposes of testing for an experience effect, we collapse this variable into two categories using a ten year cut-off point. This cut-off provides 27 (41%) respondents in the less experienced group and 39 (59%) in the more experienced group.[5]

Tables III to VII report the results of analyses of variance for each of the corporate governance manipulations, together with the experience effect. For each table, Panel A reports descriptive statistics (means, standard deviations and cell sizes), while Panel B reports the analysis of variance results.

INSERT TABLES III TO VII ABOUT HERE

Overall, the descriptive statistics reported in these tables suggest a relatively high level of ethical awareness by respondents. Recall that the second question asked the respondent to assume that the internal auditor in the scenario did not raise or report an issue. They were then asked to assess how ethical this lack of action would be by marking a point on a 9-point scale where 1 represents “extremely unethical” and 9 represents “extremely ethical”. These results are reported in the columns headed “Ethical assessment”. Across all the scenarios, the overall means range from a low of 2.42 for scenario 4 to a high of 3.35 for scenario 1, well below the mid-point of 5 on the scale. Thus, in general, respondents appear to be reasonably sensitive to unethical behaviour. However, they are less convinced that the internal auditors in the scenarios would actually behave in an ethical manner. Again, recall that the first question asked respondents to indicate the likelihood that the internal auditor would raise or report the issue. Using a 9-point scale where 1 represents “highly unlikely” and 9 represents “highly likely”, the mid-point of 5 would suggest a neutral position. Overall means across the five scenarios for this likelihood judgment are relatively close to the mid-point, ranging from a low of 5.06 for scenario 5 to a high of 6.17 for scenario 4.

Scenario 1 involves the chief internal auditor (CIA) raising a material revenue recognition issue with the audit committee when being pressured not to do so by the financial controller. The strength of the audit committee is manipulated as stronger or weaker. Panel A of Table III indicates that the cell means for question 1 (likelihood judgment) range from 5.07 to 5.53, implying that respondents are not strongly convinced that the CIA would report to the audit committee. The means for question 2 (ethical assessment) range from 3.16 to 3.60, suggesting that a failure to report the issue, while unethical, is not considered to be extremely so. Panel B of Table III indicates that neither the audit committee manipulation nor level of experience influences the responses to questions 1 and 2. This suggests that internal auditors, regardless of their level of experience, would not be influenced by the strength of the audit committee when deciding whether to report to the committee.

Scenario 2 concerns the CIA of a government department raising an accounting policy change with the Minister at the annual accounts review. Management’s attitude to changing accounting policies is manipulated as a consistent application of policies or frequent changes to policies, reflecting their level of integrity in this regard. Panel A of

Table IV shows that the means for the likelihood judgment generally exceed 6.0, suggesting a relatively high expectation that the CIA would raise the issue with the Minister. The means for the ethical assessment are broadly similar to those in the first scenario. Again, Panel B shows that neither of the independent variables significantly influences these judgments.

Scenario 3 relates to the CIA raising a possible environmental liability with the external auditors. Management integrity is manipulated as weaker or stronger by reference to the application of pressure on the CIA by the chief executive officer (CEO) in the weaker case, with no such pressure in the stronger case. Panel A of Table V suggests that respondents are sensitive to the unethical behaviour in this case, with all of the means for the ethical assessment being less than 3.0. The means for the likelihood judgment are lower for less experienced respondents compared to more experienced respondents and Panel B indicates that this difference is statistically significant ($p = .006$). More experienced internal auditors are more convinced that the CIA in the scenario would act ethically than are their less experienced counterparts.

Scenario 4 involves the CIA of a city council reporting management fraud to the council and recommending prosecution. Mitigating circumstances are that the manager involved admits that he stole council assets to fund medical expenses for a sick child and that he has started to make full recompense for his thefts. He has also resigned from the council. The strength of the council's code of ethical conduct is manipulated so that, on the one hand, a detailed code exists, listing specific ethical issues and appropriate actions while, on the other hand, a very general and vaguer code is in place. Table VI (Panel B) indicates that differences in the code of conduct do not appear to influence responses.

However, there are significant experience effects for both the likelihood judgment ($p = .000$) and the ethical assessment ($p = .015$). Panel A shows that more experienced internal auditors expect the CIA to report to Council and to recommend prosecution while less experienced respondents are less convinced that such action would be taken. While both groups assess a lack of action to be unethical, the more experienced respondents' scores are closer to the end-point of "extremely unethical".

Scenario 5 concerns reporting the possibility of management fraud to the financial controller and external auditor. In this case, the internal auditor is standing in for the CIA at a meeting with these parties. External audit characteristics are manipulated to reflect a higher level of independence and commitment to quality on the one hand, and a less independent, lower quality firm on the other. The results are reported in Table VII. Panel B reports a significant external auditor effect for both the likelihood judgment and the ethical assessment ($p = .023$ and $p = .027$ respectively). Panel A shows that respondents in the more independent/higher quality auditor treatment believe that the internal auditor is more likely to raise the issue of concern at the meeting compared to those in the less independent/lower quality treatment. The more independent/high quality group also assesses a lack of action to be more unethical than does the less independent/lower quality group. There is also a weakly significant experience effect with respect to the ethical assessment ($p = .056$), with more experienced respondents assessing a lack of action to be more unethical than the less experienced respondents.

Overall, as far as RQ1 is concerned, it appears that other corporate governance mechanisms have a minimum effect on the ethical judgments of internal auditors. The exception appears to be external auditor independence and quality, with internal auditors being likely to raise issues with the external auditor and assessing a failure to do so as more unethical when the external audit firm is of higher quality and more independent. With regard to RQ2, our results indicate that there are some differences in ethical judgments based on years of experience, with more experienced internal auditors adopting a more ethical stance in some circumstances. This finding is broadly consistent with that of Larkin (2000).

Concluding Comments

The objectives of this study were to evaluate internal auditors' sensitivity to ethical dilemmas and to examine the impact of corporate governance mechanisms on their ethical decision making. We also examined the effect of experience on internal auditors' judgments. We found that internal auditors as a group demonstrate a reasonably high sensitivity to ethical issues but that they are not always convinced that their peers would behave in an ethical manner. Other key corporate governance mechanisms appear to have little impact upon internal auditors' ability to act ethically when presented with a workplace dilemma. Given five corporate governance support factors, internal auditors only appear to regard the strength of the external audit function as having a positive effect on ethical decision making. The existence of an effective audit committee, a strong organisational code of conduct and high management integrity do not appear to assist internal auditors to act more ethically when faced with a dilemma. We also found a significant experience effect in three of the five scenarios, with more experienced internal auditors adopting a more ethical stance than less experienced auditors. The results of our study have implications for the internal audit profession with respect to training and the provision of support mechanisms to strengthen the ability of the internal auditor to withstand pressure when faced with ethical dilemmas.

There are a number of limitations of our study. First, our sample was a self-selected sample drawn from internal auditors attending a conference. Given that those attending the conference are likely to be highly motivated members of their profession, and that those responding to the survey are likely to be those with an interest in ethical issues, the sample may not be representative of internal auditors in general. Second, the sample comprises mainly Australian males and thus we are unable to explore the possibility of both gender and country differences in ethical decision making. Third, our failure to find significant corporate governance effects may be due to a lack of variability in our manipulations given the between-subjects design. For example, those in the weak audit committee treatment group may still have perceived the audit committee to offer some protection to the internal auditor. Similarly, the weaker code of conduct treatment may have been perceived as offering some guidance to the internal auditor.

There are many opportunities for further research in this area. Similar studies can be undertaken using a broader sample of internal auditors. The corporate governance mechanisms examined in this study could be manipulated in a more extreme manner and different ethical scenarios could be developed. The impact of other mechanisms such as board independence, CEO/board chair duality, risk management procedures and whistle-blowing policies could also be explored. Finally, studies could incorporate other contextual and individual factors such as national culture, organisational culture, level of moral development, organisational commitment and gender.

Appendix 1 – Example Ethical Scenario and Questions from the Research Instrument

Scenario 1

Tom is in his first year as chief internal auditor for Refrigerators Ltd. reporting directly to the CEO. Management's new sales policy of selling refrigerators to clients and extending the normal one year warranty to two, on payment of an extra $300 at time of purchase, has proved very successful. This has a material effect on the turnover figure. Sales have increased 30%. Tom notes however that the total revenue is being recognised in the first year instead of deferring the $300 to the second year. Tom wishes to raise the issue for discussion with the **audit committee**, whom he meets with every quarter. The financial controller disagrees and says, "It's a done deal" and that the CEO wants it to remain that way. Once they sign up, she explains, they're effectively tied in so we can recognise the total revenue immediately. She is an executive director and stresses to Tom she does not want the matter raised with the audit committee, as it's frivolous. She also stresses Tom's first year performance review with the CEO is to be undertaken shortly.

Refrigerators Ltd.'s new **audit committee** meets quarterly. It is comprised of one former auditor, now a non-executive director and two other non-executive directors both of whom have significant accounting experience. The audit committee's new charter states they are to actively review compliance with significant accounting standards. The audit committee reports to the full board after each meeting.

What do you think would be the likelihood of Tom raising the issue of revenue recognition with the Audit Committee at his next meeting:

Highly Unlikely Highly Likely

1 2 3 4 5 6 7 8 9

Now assume that Tom does not raise the issue with the board at his next meeting. Please indicate the extent to which you believe that Tom's action is ethical or unethical:

Extremely Unethical Extremely Ethical

1 2 3 4 5 6 7 8 9

Endnotes

[1] As evidenced, for example, by the collapse of companies such as *Enron, Sunbeam* and *WorldCom* in the United States and *HIH, Harris Scarfe* and *One-Tel* in Australia.
[2] Most of these studies use Rest's (1979 and 1994) defining issues test (DIT) to measure accountants' level of moral development.
[3] An example of one of the scenarios is given in Appendix 1.
[4] The terms "stronger" and "weaker" only have meaning relative to each other.
[5] Other cut-off points did not generate significant experience effects.

Acknowledgements

The authors with to thank the Accounting and Finance Association of Australia and New Zealand (AFAANZ) for a research grant which made this project viable. They also wish to express their gratitude to the Institute of Internal Auditors (IIA) Australia, for their assistance and support for the research instrument which was distributed to delegates at an IIA conference.

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TABLE I
Ethical Dilemma and Manipulation of Corporate Governance Factors

Dilemma	**Factor**	**Strong/Good**	**Weak/Poor**
- CIA of company - Raising material accounting issue with audit committee - Recognising revenue ahead of time - CIA pressured by financial controller (an executive director) not to raise with audit	**Audit Committee**	- Meets quarterly and reports to Board quarterly. - All non-executive directors, all with accounting expertise. - Organisation's charter empowers Audit Committee (AC) to actively 'review and pursue'.	- Meets half-yearly and reports to Board annually. - All non-executive directors but only one with accounting expertise. - Organisation's charter only empowers AC to review overall results and annual report.

committee			
- CIA of Government department -Raising material accounting policy change with Minister at annual accounts review - Change in depreciation rate by joint-venture entity - Financial officer refuses to provide supporting evidence	**Management Integrity** (evidenced by changes to accounting policies)	- Accounting policies applied consistently from period to period. - Few changes, all thoroughly explained with a clear demonstration of profit effect.	- Accounting policies changed on a surprisingly regular basis. - All changes are appropriately disclosed but information and explanations are at a minimum.
- CIA of company - Raising possible contingent liability (environmental liability) with external auditors	**Management Integrity** (evidenced by pressurising Internal Audit)	- Diversified Board - CEO (executive director) less powerful -CEO does not apply pressure to CIA	- Board dominated by one family - CEO (executive director) more powerful (family member) - CEO applies pressure to CIA
- CIA of city council - Reporting fraud to council, recommending prosecution -Theft of assets by manager to pay for medical expenses of sick child - Manager resigns and starts to make full recompense	**Code of Conduct**	- Organisation's *Accounting and Procedural Arrangements Manual*, includes a detailed "Code of Conduct". - Specifically lists several ethical issues and the actions to be taken.	- Organisation's *Accounting and Procedural Arrangements Manual*, includes a very general "Code of Conduct". - Does not specifically list ethical issues. Vague as regards actions to be taken.
- IA of company - Raising an unusual expense that suggests management fraud with financial controller (FC) and external auditor (EA) - IA has to stand in for CIA at meeting with FC (board member, son of company founder) and EA	**External Auditors**	- Respected second tier firm. - Second year as auditors and the board respects them. - Threatened to resign last year unless certain matters were disclosed in the final accounts.	- Small suburban firm. - Long association with board, board treats them as a friend. - Once accounts are lodged on time and all appears reasonable, they are satisfied.

CIA = chief internal auditor; IA = internal auditor; CEO = chief executive officer

TABLE II Details of Respondents		
	No.	**%**
Gender:		
Male	58	88
Female	8	12
Sector working in:		
Public	47	71
Private	19	29
Country		
Australia	56	85
New Zealand	8	12
Other	2	3
Years of internal auditing experience:		
Less than 2 years	5	8
2-5 years	8	12
5-10 years	14	21
10 - 20 years	24	36
20 years or more	15	23

TABLE III
Scenario 1 – Strength of Audit Committee

Panel A: Means (standard deviations) and cell sizes

	Less than 10 years		10 years and more		Overall	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
Stronger audit committee	5.50 (1.73)	3.17 (1.11)	5.30 (2.41)	3.45 (2.11)	5.38 (2.15)	3.34 (1.79)
	n = 12		n = 20		n = 32	
Weaker audit committee	5.07 (2.22)	3.60 (2.50)	5.53 (2.17)	3.16 (1.07)	5.32 (2.17)	3.35 (1.82)
	n = 15		n = 19		n = 34	
Overall	5.26 (1.99)	3.41 (1.99)	5.41 (2.27)	3.31 (1.67)	5.35 (2.14)	3.35 (1.79)
	n = 27		n = 39		n = 66	

Panel B: Analysis of Variance

Source of variation	Mean Square		F		Sig. of F	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
Audit committee	.170	.079	.035	.024	.851	.878
Years of experience	.267	.100	.056	.030	.814	.863
Interaction	1.722	2.083	.360	.625	.551	.432

Likelihood of action: 1 = highly unlikely; 9 = highly likely
Ethical assessment: 1 = extremely unethical; 9 = extremely ethical

TABLE IV
Scenario 2 – Management Integrity (Consistency of accounting policies)

Panel A: Means (standard deviations) and cell sizes

	Less than 10 years		10 years and more		Overall	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
Good management attitude to changing accounting policies	6.40 (2.41)	3.53 (2.47)	6.32 (2.19)	3.26 (1.88)	6.35 (2.25)	3.38 (2.13)
	n = 15		n = 19		n = 34	
Poor management attitude to changing accounting policies	5.75 (1.91)	2.75 (1.36)	6.00 (2.51)	3.35 (2.21)	5.91 (2.27)	3.13 (1.88)
	n = 12		n = 20		n = 32	
Overall	6.11 (2.19)	3.19 (2.06)	6.15 (2.33)	3.31 (2.03)	6.14 (2.26)	3.26 (2.03)
	n = 27		n = 39		n = 66	

Panel B: Analysis of Variance

Source of variation	Mean Square		F		Sig. of F	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
Management attitude	3.692	1.920	.698	.454	.407	.503
Years of experience	.109	.431	.021	.102	.886	.751
Interaction	.442	2.997	.084	.709	.773	.403

Likelihood of action: 1 = highly unlikely; 9 = highly likely
Ethical assessment: 1 = extremely unethical; 9 = extremely ethical

TABLE V
Scenario 3 – Management Integrity (Pressure exerted on Internal Auditor)

Panel A: Means (standard deviations) and cell sizes						
	Less than 10 years		10 years and more		Overall	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
No pressure exerted	4.73 (2.09)	2.60 (1.40)	6.21 (1.72)	2.26 (1.24)	5.56 (2.00)	2.41 (1.31
	n = 15		n = 19		n = 34	
Pressure exerted	5.00 (1.95)	2.67 (1.30)	6.20 (1.79)	2.85 (1.81)	5.75 (1.92)	2.78 (1.62)
	n = 12		n = 20		n = 32	
Overall	4.85 (1.99)	2.63 (1.33)	6.21 (1.73)	2.56 (1.57)	5.65 (1.95)	2.59 (1.47)
	n = 27		n = 39		n = 66	
Panel B: Analysis of Variance						
Source of variation	Mean Square		F		Sig. of F	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
Pressure	.260	1.691	.074	.768	.786	.384
Years of experience	28.371	.093	8.095	.042	.006	.838
Interaction	.304	1.071	.087	.486	.769	.488

Likelihood of action: 1 = highly unlikely; 9 = highly likely
Ethical assessment: 1 = extremely unethical; 9 = extremely ethical

TABLE VI
Scenario 4 – Code of Ethical Conduct

Panel A: Means (standard deviations) and cell sizes

	Less than 10 years		10 years and more		Overall	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
Stronger code of conduct	5.20 (2.43)	2.87 (1.79)	7.00 (2.13)	1.79 (0.63)	6.21 (2.10	2.26 (1.33)
	n = 15		n = 19		n = 34	
Weaker code of conduct	4.67 (2.39)	3.25 (2.45)	7.00 (1.41)	2.20 (1.79)	6.13 (2.47)	2.59 (2.09
	n = 12		n = 20		n = 32	
Overall	4.96 (2.38)	3.04 (2.05)	7.00 (1.79)	2.00 (1.36)	6.17 (2.27)	2.42 (1.74)
	n = 27		n = 39		n = 66	

Panel B: Analysis of Variance

Source of variation	Mean Square		F		Sig. of F	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
Code of conduct	1.126	2.495	.261	.877	.611	.353
Years of experience	67.626	17.911	15.399	6.297	.000	.015
Interaction	1.126	.003	.261	.001	.611	.975

Likelihood of action: 1 = highly unlikely; 9 = highly likely
Ethical assessment: 1 = extremely unethical; 9 = extremely ethical

TABLE VII
Scenario 5 –External Audit Characteristics

Panel A: Means (standard deviations) and cell sizes

	Less than 10 years		10 years and more		Overall	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
More independent external auditor	5.25 (2.30)	3.08 (2.23)	6.15 (2.60)	1.75 (0.79)	5.81 (2.49)	2.25 (1.61)
	n = 12		n = 20		n = 32	
Less independent external auditor	4.40 (2.41)	3.47 (2.10)	4.32 (1.80)	3.21 (1.40)	4.35 (2.06)	3.32 (1.72)
	n = 15		n = 19		n = 34	
Overall	4.78 (2.36)	3.30 (2.13)	5.26 (2.40)	2.46 (1.33)	5.06 (2.38)	2.80 (1.74)
	n = 27		n = 39		n = 66	

Panel B: Analysis of Variance

Source of variation	Mean Square		F		Sig. of F	
	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment	Likelihood of ethical action	Ethical assessment
External auditor	28.520	13.458	5.416	5.101	.023	.027
Years of experience	2.634	10.000	.500	3.791	.482	.056
Interaction	3.834	4.593	.728	1.741	.397	.192

Likelihood of action: 1 = highly unlikely; 9 = highly likely
Ethical assessment: 1 = extremely unethical; 9 = extremely ethical