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In Search of a Measure of Effectiveness for Internal Audit Functions: An Institutional Perspective

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Abstract

Internal auditing (IA) effectiveness is still viewed, to large extent, as a ‘black box’ in academic research. In this paper, relevant empirical studies based on self-assessments of internal auditors and on other stakeholders’ perspectives are reviewed through an ‘effectiveness lens’. Major patterns are identified in the existing literature, and the paper complements the work of Gramling *et al.* (2004), who examined the literature related to IA quality, largely from the viewpoint of external auditors. This paper reviews the empirical literature on IA effectiveness that has been published since the latest revision of the IA definition in 1999, using the perspectives of new institutional theory and institutional entrepreneurship (DiMaggio and Powell, 1983; DiMaggio, 1988) as a framework, thereby recognizing the tension between institutional forces and the role of agency. In cases where isomorphic forces are in conflict with other organizational demands, chief auditing executives (CAE) agency can be a solution that enables local adaptation (institutional entrepreneurship). The ability to exploit fully the potential of agency is an opportunity for the CAE to tailor and advance the role of IA in its specific organizational context.

Key words: Internal auditing, effectiveness, new institutional theory, institutional entrepreneurship

1. Introduction

Internal auditing (IA) could become a central pillar of corporate governance, and be instrumental, for example, in fighting mismanagement, inappropriate risk-taking and fraud. Presently, however, IA is still an emerging profession, yet to be more fully understood and valued, and the implied requirement that IA should be effective (Dittenhofer, 2001, p. 444) deserves more attention in academic research than it has received. In practice, IA effectiveness has been actively debated (e.g., Ernst & Young, 2006, 2008, 2010, 2012; IIA Audit Executive Center, 2009; KPMG, 2009; Deloitte, 2010; PwC, 2009, 2010, 2012), but in academic research, IA effectiveness remains underexplored (e.g., Anderson, 2003; Hermanson and Rittenberg, 2003; Prawitt, 2003; Gramling *et al.* 2004; Arena and Azzone, 2007; Paape, 2008; Sarens, 2009; Cohen and Sayag, 2010).

Prawitt (2003, p. 172), for example, acknowledged that 'managing and staffing an IA function (IAF) is a complex undertaking that remains relatively unexplored by rigorous research'. Paape (2008, p. 37) regarded IA effectiveness as a 'totally unexplored area', while Arena and Azzone (2007, p. 110) suggested that 'future studies could address the problem of the effectiveness of internal audit units'. Anderson (2003, pp. 102, 123) questioned who the ultimate customer of IA is and how potential trade-offs among conflicting customer demands are to be managed. Hermanson and Rittenberg (2003) questioned who judges the effectiveness of IA and encouraged future research. Sarens (2009) explored when we can talk about an effective IAF, postulating that the parameter should be whether the IAF has a positive influence on the quality of corporate governance, thereby distinguishing at least two components that merit further investigation: the characteristics of the IAF as a whole and the characteristics of the individual auditor. Therefore, the aim of this conceptual paper is to critically evaluate IA practices through an effectiveness lens based on an in-depth literature review.

Little help is available on IA effectiveness in the professional standards of the Institute of Internal Auditors (IIA) (IIARF, 2011a), since these may be considered what Jeppesen (2010, p. 189) called 'soft texts', that is, texts that are non-committal and allow a certain degree of interpretation. Therefore, IA effectiveness is an enigma, as the 'criteria of effectiveness are opaque' (Power, 1997, p. 10).

The purpose of this paper is to clarify the enigmatic phenomenon of IA effectiveness by reviewing the relevant empirical literature, generally considering publications since the latest revision of the IA definition in 1999, but older references are included if they are of particular relevance. Two streams of empirical literature are reviewed: the ‘supply-side perspective’, that is, empirical studies based on self-assessments of internal auditors; and the ‘demand-side perspective’, that is, empirical studies based on other stakeholders’ perspectives. The literature is screened through the perspective of new institutional theory to provide an updated overview of the contributions of relevant academic studies to the body of knowledge on IA effectiveness. This paper builds on Dittenhofer’s (2001) definition of IA effectiveness and complements the work of Gramling *et al.* (2004), who examined the literature related to IAF quality largely from the perspective of external auditors and who encouraged investigation into other factors that affect the role of the IAF in corporate governance.

The paper is outlined as follows. Section 2 defines IA effectiveness as a ‘risk based concept that helps the organization to achieve its objectives by positively influencing the quality of corporate governance’. Section 3 introduces new institutional theory as a framework with which to group the literature, thereby building on DiMaggio and Powell’s (1983) isomorphic forces: coercive force, normative force and mimetic force. Section 4 presents literature that views IA effectiveness as coercive isomorphism, while Section 5 points to literature that stresses the effect of normative isomorphism and Section 6 views IA effectiveness as driven by mimetic isomorphism. The patterns in the literature are discussed in Section 7, recognizing the tension between institutional forces and the role of agency (DiMaggio, 1988). Section 8 concludes, summarizes the findings, and suggests questions and perspectives for future research and practice.

2. Define IA effectiveness as a ‘risk based concept that helps the organization to achieve its objectives by positively influencing the quality of corporate governance’

Ridley (2008, p. 287) claimed that modern IA has been constructed upon the ‘three Es’ of effectiveness, efficiency and economy. Chambers (1992, p. 22) viewed effectiveness as ‘doing the right thing’, while efficiency means ‘doing them well’ and economy means ‘doing them cheaply’. Effectiveness is the most important of the three ‘Es’. If IA is ineffective, it does not matter how efficiently or economically the service is rendered. Dittenhofer (2001, p. 450) emphasized that what really matters to an organization is effectiveness, as efficiency in ineffective pursuit is of no benefit at all: the most irrelevant areas can be audited in a highly efficient way.

When something is ‘effective’, it is adequate to accomplish its purpose and to ensure ‘the achievement of a desired condition’ (Dittenhofer, 2001, p. 445). According to Dittenhofer (2001, p. 450), effective IA helps organizations to achieve their objectives, although Dittenhofer acknowledged the difficulty in determining the appropriate measurement criteria with which to confirm effectiveness. Thus, effectiveness, particularly IA effectiveness, is not self-explanatory, so it must be defined. Auditing is a credence good (Causholli, 2009), that is, the audit customers cannot discern the quality of the good even after purchasing and consuming it. Therefore, audit quality is not directly observable except in the event of an audit failure; it is relatively easy to see in hindsight when an audit was not effective (Bender, 2006).

We find inspiration for exploring the effectiveness concept in performance auditing, where effectiveness is generally considered a ‘goal-attainment concept’ (ISSAI 3000). This implies that effectiveness is concerned with the relationships among goals or objectives, outputs and outcomes (effects), all of which may often not be straightforward in practice, especially as goals may be vague, conflicting or non-existent (ISSAI 3000). According to Power (1997, p. 115), the distinction between outputs and outcomes is a critical one: we regard the IA report as an output that cannot be effective per se but that may trigger intended change. What matters is that intended change - the (specific) outcome (and possibly lasting effects) that accomplishes the desired improvement (Brombacher 2012, p. 395), along with evidence of causality between the IA report and the achieved objective. Naturally, effectiveness must also be considered in the light of the costs of achieving the goals, and IA has recently been criticized for not providing value for money[1].

[1] The U.K. National Audit Office (NAO) scrutinized public spending and concluded: ‘Internal audit ... costs around GBP 70 million a year … however, government does not get value for money from its internal audit service’ (NAO, 2012).

We define IA effectiveness as a ‘risk based concept that helps the organization to achieve its objectives by positively influencing the quality of corporate governance’. Modern IA is risk based (Spira and Page, 2003); ‘a good IA service gets to the heart of the issues facing the organization’ (NAO, 2012, p. 5). The IIA Performance Standard 2010 (IIARF, 2011a, p. 26) demands risk-based internal auditing (RBIA), a concept that has been subject to IIA position papers (IIA UK and Ireland, 2005; IIA, 2009). The focus on critical risks and issues, and the importance of RBIA is further supported by the literature (e.g., Allegrini and D’Onza, 2003; Burnaby and Hass, 2009; Ernst & Young, 2012; PwC, 2010). IA is a service to the business. Effective IA reviews the major areas of risk in order to help organizations achieve their objectives. IA contributes to the achievement of objectives by positively influencing corporate governance, thereby building on Sarens (2009). The level of ‘goal-attainment’ for what IA is concerned correlates with the IAF’s influence on corporate governance. The suggested definition understands ‘governance’ as an umbrella term also including risk management and internal control. To remove ambiguity, the suggested definition explicitly refers to IA as a risk based concept since grounding the work of IA on the assessment and monitoring of the major areas of risks is fundamental.

We use new institutional theory as a relevant perspective in studying the existing research on IA effectiveness because the theory explains and critically evaluates the diffusion of organizational order: ‘DiMaggio and Powell’s (1983) useful typology focuses attention on three contrasting mechanisms - coercive, normative, and mimetic - that identify varying forces or motives for adopting new structures and behaviors’ (Scott, 2008, p. 133). To approach IA effectiveness through the perspectives of coercive, normative, and mimetic isomorphism may thus help us to identify the carriers of institutions that convey a common perception of IA effectiveness and practices. The relevance of institutional forces in influencing companies’ behavior regarding IA is also supported by Arena and Azzone’s (2007) survey of 364 Italian companies.

3. Introduction of institutional theory

Institutional theory is founded on the work of Max Weber (1980) on rule and legitimacy, and Scott (2008, p. 151) reported that ‘Weber was among the first social theorists to call attention to the central importance of legitimacy in social life’. According to Weber, a ruler may be forced out of office if he or she lacks legitimacy, that is, when he or she lacks support from the people and when the people see a more promising alternative path to satisfying their goals than obedience to the ruler. The same logic applies to institutions[2] and organizations, in general, and to IA, in particular. Legitimacy is needed in order to survive, and providing evidence of added value and effectiveness is one way to be perceived as legitimate in the eyes of major stakeholders. Providing such evidence is not an easy task for internal auditors, as their work is not connected directly to the profit and loss account. The value of support functions, as they are often called in practice, is difficult to assess since meaningful measurement criteria are typically of a qualitative, rather than a quantitative, nature (Nobel, 2010).

The conceptual framework provided by the IIA Research Foundation (IIARF, 2011b, p. 2) posits that many factors affect the value of IA, while the determinants of IA value are IA’s contribution to governance, risk management, and control processes, as they are perceived by the board/AC, SM and other stakeholders. Key factors of such determinants include laws and regulations, corporate governance structures and the AC, compliance with the IA standards, organizational characteristics, characteristics of the individual internal auditor and the CAE. These factors correspond to some extent with the features of institutional theory, which some scholars have applied as a theoretical framework in the context of IA (e.g., Al-Twaijry *et al.*, 2003; Arena *et al.*, 2006; Arena and Azzone, 2007; Arena and Jeppesen, 2012). When DiMaggio and Powell (1983, pp. 147, 150) studied ‘what makes organizations so similar’, they observed that ‘rational actors make their organizations increasingly similar as they try to change them’. Such actors respond similarly to three mechanisms - coercive forces, normative forces, and mimetic forces - causing what DiMaggio and Powell called ‘institutional isomorphic change’. In the context of IA, these three forces demand compliance with cultural expectations e.g. in the form of laws and regulations,

[2] See Scott’s (2008, p. 48) conception of institutions: ‘Institutions are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life’.

adherence to the professional norms, e.g. as promulgated by the IIA (IIARF, 2011a), and imitation of other IAFs by mimicking others' apparently legitimate practices.

While institutional studies that pursue an 'interest-free model' (DiMaggio, 1988, pp. 4-5) have de-emphasized human agency to the degree humans are viewed almost as robots or puppets (Mouritsen, 1994), neo-institutional theorists recognized early that human agency sometimes was needed to account for organizational change. In seeking a way to come to terms with the role of interest and agency, DiMaggio (1988, p. 14) introduced the concept of the 'institutional entrepreneur', being an organized actors with sufficient resources who create new legitimate organizational forms. Figure 1 embeds agency into the concept of institutional theory and refers explicitly to the board/AC, SM, the CAE and any other stakeholders there may be.

[Insert Figure 1]

Inspired by Seo & Creed (2002) and Greenwood & Suddaby (2006), the model includes agency to account for cases, where institutional forces are in conflict, where they are inconsistent with central values or interests in the organization, or where the organization for some reason is not able to adapt to institutional forces, thus forcing central actors such as the CAE to react.

We use the three institutional forces of coercive isomorphism, normative isomorphism and mimetic isomorphism as major dimensions in reviewing the relevant empirical studies. The next three sections on isomorphism are modeled similarly: we start with expectations, that is, what we should expect to see in relation to IA effectiveness, followed by what we find in the present body of literature and, finally, a brief summary of what we know and what needs further research.

The paper groups the literature according to three institutional forces as summarized in Table 1.

[Insert Table 1]

We first discuss coercive isomorphism as an institutional force that may serve to open the door for IA, as in the Italian case, where regulations have a strong influence on the development of IA (Arena *et al.*, 2006).

4. Coercive isomorphism

Organizations are often forced to adapt to the cultural expectations of their surroundings to gain legitimacy, a process which DiMaggio and Powell (1983) termed 'coercive isomorphism'. As cultural expectations become more homogeneous, the same is expected of organizations. Cultural expectations frequently manifest themselves in the form of regulation; therefore from this perspective, the measure of IA effectiveness is primarily associated with compliance with laws and other binding regulations. Thus, IA may be considered legitimate and effective if it complies with society's expectations in the form of regulation.

The importance of regulation for IA is frequently emphasized in literature. In a multiple case study in Italy, Arena *et al.* (2006, p. 288) underpinned the power of legislative forces, confirming coercive isomorphism and observing that 'companies are subject to rules and regulations to which they tend to conform so as to ensure their legitimacy'. That phenomenon is stronger when regulations impose sanctions, as in the case of Italian companies listed on the New York Stock Exchange (NYSE), which requires that all listed companies have an IAF. Similarly, Arena and Jeppesen (2012) regard coercive forces as the most powerful force in triggering change.

While the NYSE listing rules mandate the presence of an IAF (NYSE Section 303A.07)[3], the size and nature of that function are not specified, and the NYSE does not address its effectiveness (Carcello *et al.*, 2005a), perhaps, because the regulator has no clear perspective on what IA effectiveness means, what its determinants are or what it looks like. Still, Carcello *et al.* (2005a) regarded coercive force as an important driver of change, such as in the case of the NYSE requirements that heighten efforts to force compliance with the Sarbanes-Oxley Act (SOX) from 2002.

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[3] See Audit Committee Additional Requirements, 303A.07 Section (c): 'Each listed company must have an internal audit function.' This site was accessed on 20 March 2012, available at http://nysemanual.nyse.com/LCMTools/TOCChapter.asp?manual=/lcm/sections/lcm-sections/chp_1_4/default.asp&selectedNode=chp_1_4_3

Carcello *et al.* (2005b, p. 124) 'find that IA budgets, staffing levels, meetings with the AC, and meeting length increased markedly from 2001 to 2002'.

Hermanson *et al.* (2008) systematically reviewed IA-related problems revealed in SOX Section 404 reports and offered specific recommendations for building an effective and value-adding IAF. Although the authors did not provide a definition of IA effectiveness, they interpreted as a sign of effectiveness the absence from SOX Section 404 of material weaknesses caused by IA-related problems. The study by Lin *et al.* (2011, p. 288) linked IAF attributes and activities with an observable outcome-based measure of IA effectiveness, that is, the disclosure of SOX Section 404 material internal control weaknesses, and stated that it 'lends support to the requirement that NYSE-listed companies maintain an IAF'. Lin *et al.* (2011) showed, among other findings, that the effectiveness of EA's SOX Section 404 procedures can be enhanced by cooperating with a firm's IAF. In addition, various IA activities help IA effectiveness, including the use of quality assurance techniques, grading IA reports and performing follow-up on issues securing remediation.

The board/AC and SM have been primarily concerned with compliance with SOX in the aftermath of the bankruptcy of WorldCom and Enron in 2002-2003. SOX in the U.S. placed particular focus on financial reporting and its associated controls, and absorbed up to 70% of the IAF capacity in the U.S. in 2004, gradually declining to about 20% by 2008 (IIARF, 2009). IA has made a difference when it has been effective in contributing to minimizing or even completely avoiding material weaknesses in the internal control system, with financial reporting being the prime area of interest.

Marks (2012) warned that the narrow focus on SOX might undermine the effectiveness of IA, as resources may be cut back on audits of other risk areas. That may be less of a concern nowadays, as firms may use a risk-based approach to Section 404 compliance (Lin *et al.*, 2011, p. 319; Marks, 2012, p. 44). PwC's survey (2009) demonstrated that only 13% of respondents spent 25% or more of their resources on strategic and business risks, while these two risk areas are the prime causes of value destruction (60%), followed by operational problems (20%), and only 15% stem from financial risks and a mere 5% from compliance-related risks. As compliance ranks first in practice (IIARF, 2007), it becomes evident that IAFs tend to allocate time and resources poorly, and often seem to examine the wrong issues, exerting too much effort towards auditing financial reporting and compliance controls at the expenses of more critical and relevant strategic, business and operational audit subjects.

The European Union's 8th Directive (2006/43/EC, Article 41), called by some 'the European SOX', requires that each public-interest entity in the European Union have an AC, tasked to 'monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems'[4]. An IAF is not mandatory in the European Union, so labeling the 8th Directive 'the European SOX' is misleading. There is only limited and indirect coercive force to have an IAF because someone needs to carry out the monitoring work, and that can be the IAF. However, an IAF is not required by law, and there is no reference to effective IAF.

Regulation of the role of IA is in practice an important factor to create a profession with a distinct identity, as Arena and Jeppesen (2010, p. 112) argued in the case of Denmark, where the external audit (EA) profession controls the IA knowledge base, and 'external auditors succeeded in monopolizing the educational system for internal auditors.' To establish IA in less mature economies, some scholars have suggested adapting coercive force to gain legitimacy. Brierley *et al.* (2001, p. 73) observed in the Sudanese public sector that 'the typical internal audit department is engaged in largely the routine authorization of transactions, is staffed by inexperienced and untrained personnel, and has insufficient credibility, independence or authority'. El-Sayed Ebaid (2011) studied listed firms in Egypt and concluded that IA has not been recognized as a specialized profession. Al-Twaijry *et al.* (2003) assessed IA in Saudi Arabia as immature, non-existent in some organizations, and capable of making only limited contributions when it does exist. SM and auditees in Saudi Arabian organizations are reported to have little respect for IA and internal auditors. While Al-Twaijry *et al.* (2003) acknowledged the relevance of normative forces when establishing local chapters of the IIA, they suggested that IA in Saudi Arabia could be

[4] See Article 41, paragraph 2, section (b) accessed 20 March 2012, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0087:EN:PDF

improved if the state played a more coercive role by demanding that organizations establish IA departments.

In summary, literature indicates that companies and IAF's seek to conform to laws to secure their legitimacy. Coercive forces affect organizations to different degrees. If having an IAF is legally required, organizations have an IAF, but having an IAF says little about its effectiveness. We find that there is limited knowledge about what causes regulators to care about regulating IA. While regulators in some cases demand that firms have an IAF, regulators seldom specify what they consider effective IA. This is of interest, because the empirical literature often refers to coercive forces as drivers of change. Especially in markets that are less developed in terms of the maturity of their corporate governance, coercive force is recommended as a path through with to break the prevailing pattern and increase the value that IA can add. In these cases, regulation-demanding IA without specifying its effectiveness may be a vehicle for professionalizing the IAF. However, in most cases, regulators seem to care little about regulating IA, perhaps because caring would require understanding the IA role. The value proposition of IA, and its role and contribution, may not be clear enough to the regulators.

Next, we will discuss normative isomorphism as an institutional force, since the IIA is often considered a source of normative power. According to O'Regan (2001, p. 215), 'the IIA has been the driving force behind the increasing professionalization of internal auditing over the last half-century'.

5. Normative isomorphism

Normative isomorphism explains the diffusion of social order by referring to the professionals who span these organizations. Their professional identity determines their behavior and this explains why structures and practices become similar in the organizations that employ them. In this perspective, IA is considered effective if its professional identity makes it comply with a common body of professional knowledge. Guidance on such knowledge may be found in the International Professional Practices Framework (IPPF) provided by the IIA (IIARF, 2011a), the standard-setting body of the IA profession globally. Thus, the stronger the normative force of the IIA, the more effective the IAF may demonstrate itself to be by complying with IIA regulation.

Normative isomorphism assumes that IA has a distinct professional identity. However, there are doubts about this in light of non-compliance with the normative guidance in practice (signaling the absence of normative isomorphism), inter- and especially intra-professional competition, and the internal auditor's 'enigmatic role' (Van Peursem, 2005, p. 510). The role and contribution of the service rendered by the IAF is often not fully understood and appreciated by its key stakeholders.

In a postal research questionnaire survey in the UK, Ridley and D'Silva (1997, p. 19) found that complying with the IPPF is an important contributor to IA units' quality of service, as 'professional standards are an essential guide for ensuring that internal audit adds value through the service it provides'. However, Spira and Page (2003) referred to a gap in the rhetoric, in which the standard-bearers for IA proclaim a vision of IA, whereas the practice in organizations may be substantially different: The normative guidance provided by the IIA has been implemented in practice only partially. For example, compliance scores are lowest for Attribute Standard (AS) 1300 (quality assurance and improvement program) and Performance Standard (PS) 2600 (resolution of management's acceptance of risk), with little more than a third of CAEs claiming full compliance with AS 1300 and half of CAEs claiming full compliance with PS 2600 (IIARF, 2010, p. 65). The failure to comply with AS 1300 is ironic because it is contradictory to the power of review and assurance that is assumed. About half of the IAF represented in the Common Body of Knowledge (CBOK) studies have stated that they do not play an important role in governance and risk management, which contradicts what the IA definition prescribes. According to CBOK 2006, about a third of internal auditors had no role in risk management, and half had no role in corporate governance (IIARF, 2007, p. 55). According to CBOK 2010, only 57% of IAFs performed audits of enterprise risk management processes, and 45% performed corporate governance reviews (IIARF, 2010, pp. 24-25). Therefore, the ample guidance the IIA provides on risk management (e.g., IIA UK and Ireland, 2005 and IIA, 2009) and organizational governance (e.g., IIA, 2006) is widely ignored in practice, and there is a significant difference between what the IA definition claims IAF should do and what the IAF delivers in practice.

The lack of compliance of IA practices with the normative guidance may signal a lack of professional identity. That finding supports the work of Burns *et al.* (1994, p. 86), who do not regard IA as a ‘genuine profession’, as that would require the requisite authority to enforce its standards in practice. According to Burns *et al.* (1994), IA lacks sufficient intimidative power to gain the professional status of ‘genuine’ professions, such as medicine, law, and public accounting. Burns *et al.* (1994, p. 92) suggested that many more internal auditors are intimidated by SM than vice versa. As a litmus test, Burns *et al.* (1994, p. 93) suggested that IA test its power by threatening to withdraw or withhold future services, and ‘management could effectively respond to the IAF’s threats of resignation, withdrawal or suspension of future services by simply replacing its professional IA staff with more cooperative employees who were neither CIAs nor members of the IIA’.

The work of Burns *et al.* (1994) and Abbott (1988) may prove useful in efforts to advance the status of IA as a profession and extend the appreciation and compliance with its professional claims. In searching for IA’s professional ‘heartland’ (Abbott, 1988, p. 71), Burns *et al.* (1994, p. 112) alerted us to the concept that IA may be a ‘jack of all trades’ and ‘master of none’ and that ‘mastery over no discipline turns out to be the antitheses of a profession’. According to Abbott (1988, p. 52 and p. 103), creating and maintaining a professional jurisdiction is a balancing act, as there may be trade-offs between full clarity of purpose and a vague conception (easy target versus good defense), and between too little and too much content (not worth professionalizing versus impossible to legitimize). In addition, Abbott (1988, p. 50) acknowledged that each profession typically has certain well-recognized problems for which it knows it lacks effective solutions. From this perspective Arena and Jeppesen (2010) have suggested that IA should identify its distinct role more clearly than is presently the case to increase its chances of being recognized and acknowledged as a profession. The IIA may consider hardening its definition in order to provide the opportunity for more homogeneity in practice (at the expense of increasing exposure to criticism).

Uncertainty about the chief stakeholder of IA and the ambiguity of rendering assurance and consulting services may hurt the legitimacy and status of the IA profession (Lenz and Sarens, 2012). Van Peursem (2004) referenced the internal auditor's 'role dilemma' and 'role confusion', and she acknowledged, for example, the difficulties of internal auditors to strike the balance between being independent from operations and, at the same time, providing added value and benefit to operations. Similarly, the stakeholder's expectations and perceptions survey (IIARF, 2011c, p. 14) stated that 'IA is, by its very nature, a schizophrenic, management function. On one hand, it needs to be completely integrated and knowledgeable. But it also needs a measure of independence required of all auditors. Therefore, IA has a built in cognitive disconnect.'

In addition, there is inter- and intra-professional competition. Van Peursem (2004, p. 379) concluded that 'characteristics of a "true" profession exist but do not dominate'. In the New Zealand example, professional status is formed through membership of the Institute of Chartered Accountants of New Zealand (ICANZ) rather than through membership in the IIA (and/or ISACA). Therefore, IA is subject to normative isomorphism beyond the impetus of the (possibly emerging) IA profession. Marks and Taylor (2009, p. 1) questioned whether IA is 'one profession, two, or even more?' since there is intra-professional competition with two dominant organizations for internal auditors co-existing, the IIA and ISACA (formerly the Information Systems Audit and Control Association)[5].

Summing up, normative isomorphism suggests basing the measurement of IA effectiveness on the existence of a distinct professional identity in which compliance with the IIA standards is central. However, normative guidance has been implemented globally only in part and to various degrees, signaling the lack of a distinct professional IA identity. That is further supported by the lack of compliance with IIA standards, in particular with AS 1300 (quality assurance and improvement program). The IIA and IAFs have no power to force compliance. Therefore, IA cannot be regarded as having a distinct professional identity. IA lacks exclusivity and uniqueness in its work or in Abbott's (1988) terms, a distinct 'jurisdiction' over which it has control. Abbott (1988, p. 71) called this jurisdiction the 'heartland of work' that,

[5] The IIA Inc. in the U.S. grants the CIA designation: CIA stands for 'Certified Internal Auditor', 'the only globally accepted certification for internal auditors', see www.global.theiia.org, accessed 5 July 2012. ISACA grants the CISA designation, i.e., Certified Information Systems Auditor. ISACA claims 'CISA is to Audit what CPA and CA are to Accounting'; see www.isaca.org, accessed on 5 July 2012.

when fully developed, is ‘the characteristic of a profession over which it has complete and legally established control’. Without a distinct professional identity and a corresponding jurisdiction, normative isomorphism is not a key issue for understanding IA effectiveness.

Next, we discuss mimetic isomorphism as the third and final institutional force, as imitating others’ IA practices may be a way to create an IAF that is considered effective.

6. Mimetic isomorphism

According to DiMaggio and Powell (1983), an organization that is uncertain about the surrounding world’s expectations tends to model itself after similar types of organizations that are considered successful and legitimate. The process is known as ‘mimetic isomorphism’, and in this perspective, IA may be considered effective when there is a legitimate, institutionalized model on which to base it. For example, if a market leader applies a particular type of corporate governance and successfully runs the IAF in a certain manner, other companies may choose to mimic that model.

We searched the literature for cases on direct mimetic isomorphism in IA, but were unsuccessful. Albrecht *et al.* (1988, p. 3) expected that the roles of IA could be grouped into types of audit performed - financial, compliance, and performance auditing – and assumed that highly effective IAFs concentrate their efforts on either operational or performance audits because these benefit the company most, but these views have proved to be in error. Instead, matched expectations are the key to IAFs being regarded as effective. Therefore, we acknowledge that it is not the type of audit that matters but that the audit work performed must be consistent with SM’s and the board/AC’s expectations. Albrecht *et al.* (1988, p. 3) concluded that what matters most is ‘that the audit work is completely consistent with the objectives and role as determined by top management and the audit committee’. Flesher and Zanzig (2000) suggested that internal auditors and their customers should have a similar understanding of what makes IA a value-added activity. Gramling *et al.* (2004, p. 239) suggested further research to identify what SM and the board/AC expect from an IAF and what they are currently being provided, a view that is reminiscent of that of

Drucker (1985, p. 172), who claimed that ‘quality in a product or service is not what the supplier puts in. It is what the customer gets out and is willing to pay for.’

To the extent that these expectations are themselves products of institutions, we place the empirical literature that discusses SM’s and the board/AC’s expectations into the category of mimetic forces, although indirect. Accordingly, the following sections discuss whether there are institutionalized models regarding the relationships between IA and SM, the board/AC and EA that an IAF may mimic to gain legitimacy and appear effective.

6.1 Is there an institutionalized model of the relationship between IA and SM to mimic?

We argue that there is a prevailing institutional model of the relationship between IA and SM that is characterized by vertical relationships that move from the top down. It is a hierarchical relationship, with SM the principal and IA the agent. IA is largely viewed as dependent on SM, but that allocation of power may change when the IAF has a strong link into the board/AC.

Many academic studies support the critical influence that management support has on IA effectiveness. Albrecht *et al.* (1988, p. 7) viewed the degree of SM support for the IAF as the most critical factor in IA effectiveness. Burns *et al.* (1994, p. 92) observed the risk of internal auditors being intimidated by top management since SM may view IA as a nuisance (Burns *et al.* 1994, p. 103), especially when IA only points out shortcomings without offering ways to remediate and improve. Cooper *et al.* (1994) evidenced a wide chasm between SM and the IAF and pointed to a series of inconsistencies between the audit coverage actually performed by IA departments and its presumed scope from the Chief Executive Officer’s (CEO’s) point of view. Sarens and DeBeelde (2006a) pointed out that the higher the level of risk-based IA, the higher the status of the IAF. Sarens and DeBeelde (2006b) concluded that the acceptance and appreciation of IA in a company are strongly dependent on the support IA receives from SM. They refer to indicators of such support as, for example: open and direct communication; input to IA planning; approval of resources; response to IA recommendations; and a way to keep IA informed about what is happening in the organization. All of these dimensions - communication, input, support, and caring about IA recommendations and information - are considered indicators of IAF effectiveness.

Mihret and Yismaw (2007), in a study of the Ethiopian public sector, Halimah *et al.* (2009), in a study of the Malaysian public sector, and Cohen and Sayag (2010, p. 304), in a study of the determinants of IA effectiveness in Israeli organizations, pointed out that decisions made by SM affect IA effectiveness, such as in hiring proficient IA staff, developing career channels for IA staff and providing organizational independence for IA work. Geis (2010) identified SM's appreciation of IA as a crucial component of IA effectiveness, and Arena and Azzone (2009a) viewed SM as critical in terms of whether they do or do not implement the IAF's recommendations.

Summing up, a working relationship between IA and SM is very important, and management support is generally viewed as a critical enabler for IA to be effective. Open and direct communication, regular input to IA planning, a shared perspective on risk-based IA, and support of IA recommendations are elements of an institutionalized model that could provide legitimacy if an IAF were to follow it.

Next, we discuss the institutional model of the relationship between IA and the board/AC.

6.2 Is there an institutionalized model of the relationship between IA and the board/AC to mimic?

We argue that there is a prevailing institutional model of the relationship between IA and the board/AC. Along with Adams (1994) and Prawitt (2003, p. 173), we view the internal auditor's role as that of an agent who monitors the actions of another agent (SM), who is employed by the same principal and works in the same organization and for the same owner.

The working relationship between the internal auditor and a company's board/AC has been the subject of academic research for many years. Rezaee and Lander (1993) viewed regular interaction and open dialogue as aiding the IAF's effectiveness. Scarbrough *et al.* (1998) indicated that ACs with only non-executive directors are more likely to establish a symbiotic relationship between the AC and the IAF than are ACs with mixed memberships. Raghunandan *et al.* (2001) and Goodwin (2003) supplemented these views in examinations of the association between AC composition and the AC's interaction with IA, by showing that the independence of the AC and its members' level of finance and accounting experience have a complementary influence on the AC's relationship with IA: ACs with outside and independent directors who have finance and accounting expertise are positively correlated with active oversight, evidenced by longer and more frequent meetings with the CAE and more informal access, both of which makes the AC more likely to review the IA's program and results. Therefore, an intense working relationship between the AC and the IAF is expected to strengthen the independence and objectivity of the IAF (Goodwin and Yeo, 2001). Arena and Azzone (2009b) confirmed that IA effectiveness is positively correlated with intense interactions between IA and the board/AC.

Rose and Norman (2008) and Norman *et al.* (2010) pointed to the potential for unexpected and adverse implications when the CAE reports directly to the AC. That relationship may create threats to IA's independence and objectivity, that stem from concerns about career and reputation (especially when IA serves as a management training ground), about overreaction of AC members and about retaliation by management. De Zwaan *et al.* (2011) showed that internal auditors are not willing to report a breakdown in risk procedures to the AC when there is a strong IA-AC relationship. That conclusion was a surprise finding in the study since it did not support the original hypothesis.

Anderson (2009) discussed the extent to which IA lacks independence from SM. Abbott *et al.* (2010, p. 23) showed the potential for competing claims on IAF resources between SM and the AC and urged further research on the SM-IAF-AC relationship, as confusion about the chief stakeholder may turn the focus of the IAF away from the best way to address the company's most serious business risks.

Davies (2009) suggested that IA effectiveness depends on whether there is a board/AC that wants the IAF to examine the right things and that supports it doing so or a board/AC that is silent or that impedes the IAF from unearthing its *'skeletons in the cupboard.'*

Summing up, access to the board/AC is a key feature of an institutionalized model that could provide legitimacy if an IAF were to follow it. Regular and timely communication with the oversight body signals shared knowledge and common goals, and appreciation for the work rendered by the IAF. That can give the IAF a strong mandate, and it may strengthen the independence and objectivity of the IAF.

Finally, we discuss the institutional model of the relationship between IA and EA.

6.3 Is there an institutionalized model of the relationship between IA and EA to mimic?

External auditors are permitted by the International Auditing and Assurance Standards Board (IAASB) to regard, and rely on, the work of internal auditors. The International Standard on Auditing, ISA 610 'Using the Work of Internal Auditors' deals with this concept[6]. Richard Chambers (2012, p. 5), president and CEO of IIA Global, alerted internal auditors that 'conversations with the audit committee might prove difficult at organizations where internal audit is not ready for review'. We argue that there is a prevailing institutional model of the relationship between IA and EA that is characterized by inter-professional coordination and competition, and sometimes by IA 'subordination' (Arena and Jeppesen 2010).

EA is permanently present in the governance arena and has a seat at the governance table, as its service is legally mandated. IA's presence is not so assured, although the CAE 'can earn a seat at the table' (PwC 2012, p. 3). IA is present in that arena to varying degrees and may be marginalized or even ignored.

Abbott (1988, p. 2) found inter-professional competition to be common, as a profession cannot occupy a jurisdiction without either finding it vacant or competing

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[6] See https://www.ifac.org/sites/default/files/publications/files/A047%202012%20IAASB%20Handbook%20ISA%20610%20(Revised).pdf (accessed on 9 August 2012).

for it. Arena and Jeppesen (2010) assessed the absence of any dispute over the IA jurisdiction in Denmark, concluding that a settlement subordinating IA to EA had already taken place, but such a settlement may not apply to other contexts, so we argue that there is generally competition between EA and IA – sometimes direct and sometimes subtle. We refer to the case of India, where the Institute of Chartered Accountants of India (ICAI, 2010) demanded, after the Satyam Computer fraud case, that outsourcing of the IAF be mandatory, basically requesting that IA departments be closed and IA service be rendered exclusively by EA firms. Keizer (2009, p. 49) conceded, 'the internal auditors can function as assistants to the external auditor', and can be helpful in their independent audit of financial statements if internal auditors have the required skills. In addition, in a more subtle form of competition, EA firms have performed and published studies on IA that typically document some degree of key users' disappointment in IA's performance (e.g., Ernst & Young, 2006, 2008, 2010, 2012; Deloitte and the IIA UK and Ireland, 2008; KPMG, 2009; PwC, 2009, 2010, 2012). At the same time, such EA firms offer solutions for improvement as they are also in the business of selling IA services.

While EA in Denmark sees value in positioning IA as a subordinate profession, Arena and Jeppesen (2010) contended that the emancipation of IA from financial auditing in order to identify a distinct role requires more than a change in the definition of IA; clients, regulators and internal auditors themselves have to be convinced, and such a change also affects the talent pool and its education, training and career patterns. While EA is characterized by clear career paths, IA is often viewed as a stepping-stone to something else (O'Regan, 2001): while 'every profession has typical careers' (Abbott, 1988, p. 129), this is not yet always the case for IA.

Considerable research has assessed IAF effectiveness from the perspective of external auditors, noting that the EA view is uncertain concerning whether IA is a significant player in the governance arena or 'an assistant carrying out the directions of the audit committee and the board' (Cohen *et al.* 2010, p. 780). EA is concerned about the independence of IA and about how threats to independence (Mutchler, 2003) are mitigated, as internal auditors are typically paid by the organization to which they are supposed to render independent assurance and consulting services. Some studies provide evidence that the provision of non-audit services may harm the external auditors' independence, consequently, SOX regulation in the U.S. limited the scope of such services (Ahadiat 2011), however, potential parallels to the world of IA and the simultaneous provision of assurance and consulting services has not yet been fully examined.

The question of IA effectiveness matters to external auditors, as they may have to discuss with the AC the quality of the IAF and the extent to which the AC can rely on IA's work (Cohen *et al.*, 2007). Gramling *et al.*'s (2004) comprehensive study acknowledged that there is uncertainty regarding which criteria are relevant to evaluations of IAF quality. When external auditors determine the reliability of IA's work, they typically use objectivity (reporting relationships), work performance (coverage), and professional competence.

Krishnamoorthy (2002) approximated these criteria using observable values, such as professional certifications and the level to which IA reports to assess competence and objectivity. Other studies applied the same pattern, although observable variables that approximated the three criteria may have differed (e.g., Desai and Desai, 2010). Felix *et al.* (2001, p. 530) showed that, as IA's contribution to the financial statement audit increases, the audit fee decreases. According to Felix *et al.* (2005), client pressure is more important than the perceived quality of IA in determining the extent to which the firm relies on IA. When the IAF is used as a management training ground, EA views IA as less objective (although not as less competent), so higher fees are charged (Messiers *et al.*, 2011). Christ *et al.* (2012) found that companies that use the IAF as a management training ground experience higher accounting risk. Suspicion of self-review bias leads EA to rely less on work performed by IA when IA has been directly involved in financial system consultancy than when it has not (Munro and Stewart, 2009).

In summary, EA's view of IA quality and effectiveness has been widely addressed, but EA typically views IA as auxiliary to what EA is tasked to do. Studies that take an EA perspective have in common that they discuss IA as a function that contributes to auditing the financial statements. Contributing to the work of EA, that is, in-sourcing parts of the EA activities to save money and/or to make their work easier, and possibly more effective, can be seen as a sign of appreciation and represents an institutionalized model for the IAF to mimic in order to gain legitimacy.

6.4 Are there general institutionalized IA models to mimic?

The mimetic forces can be contextually negotiated and determined among the governance stakeholders. The legitimacy of IA is context dependent, so what provides legitimacy in one context may not in another context: what works well in one organizational context, does not necessarily work well in another. That plurality in practice is acknowledged, as the vast majority of governance frameworks used worldwide are voluntary rather than legislated - that is, they are ‘comply or explain’ rather than ‘comply or else’ (King III, 2009, p. 6) – so a ‘one size fits all’ approach is not viewed as promising because the types of business vary to such a large degree. Therefore, mimicking other IAFs’ best practices may not necessarily lead to satisfactory results.

EA pressure is most evidently an isomorphic force, but it may not be the prevailing power. When IA effectiveness is assessed from an EA perspective, IA quality is perceived as better when it has greater utilitarian benefit for EA. Thus, what EA sees in IA is dominated by the reliance question and is isomorphic: the more the work of IA is related to the topics of EA, the more appreciative EA may become. As EA is financially oriented, its focus can be far removed from the areas where IA can make a difference. Modern IA is risk based (Spira and Page, 2003, King III, 2009), which may include finance-related matters, so EA’s reliance on IA as an indicator of IA’s effectiveness can be dangerously misleading.

Meeting customer expectations serves as a useful referent of IA effectiveness, but IA has multiple customers and stakeholders in SM, the board/AC and EA, all of which may have different expectations of IA's value proposition. Therefore, meeting customer expectations can be challenging in practice, as these expectations may diverge, they may not be well communicated or well understood, and there may not be a ‘chief stakeholder’.

Empirical studies clearly point to the importance of SM and the board/AC, but they are inconclusive concerning whether there is an optimal degree of interaction and concerning which view prevails when IA serves multiple customers. Academia provides no consensus on the best reporting lines for CAE. Beasley *et al.* (2009, p. 114) highlighted 'the often nebulous, informal nature of internal audit oversight by the audit committee and management (i.e., internal audit is overseen by two parties)'. Similarly, Gramling *et al.* (2004, p. 240) suspected tension between the IAF and the board/AC and SM, as they asked, 'if the audit committee and management have different visions for the corporate governance role of the IAF, which vision will dominate?' Gramling *et al.* (2004, p. 240) assumed that the IAF puts one client first but asked, '[on] which side of the line between the audit committee and management does the IAF fall?' Christopher *et al.* (2009) addressed the challenges inherent in IA's trying to 'serve two masters' (IIARF, 2003, p. 3), which the IIA acknowledges creates the potential for conflict, pointing to an optimum that satisfies the needs of both SM and the board/AC. Christopher *et al.* (2009) concluded that the estimation of IAF independence should take into account IAF's relationship with SM and the board/AC together, rather than with each individually. Their findings suggest that the IAF's relationship with the AC is a stronger guarantee of independence than is its relationship with SM and that there may be an optimal degree of intensity (Sarens, 2009) in the relationship with SM: too much or too little involvement and direction can be harmful.

While King III (2009) regarded the board/AC as IA's 'chief stakeholder' of IA responsible for ensuring that there is an effective risk-based IA, the willingness of SM and the board/AC to cooperate with and support the IAF makes a fundamental difference in IA effectiveness. Therefore, it can be hypothesized that IA effectiveness is, to some degree, a function of board/AC and SM effectiveness. Any CAE (or IA staff member) must be able to reveal and report problems confidently and reliably without being intimidated or fearing termination of their services or employment. It can be hypothesized that the presence of a CAE who is able to address relevant issues and to stand tall when required, along with a governance framework that includes board/AC support and a symbiotic relationship between the two, enables the IAF to unlock its potential.

The patterns in the literature are discussed in Section 7, while Section 8 concludes, summarizes the findings, and suggests perspectives for future research and practice.

7. Discussion

The following section summarizes the three institutional forces' impact on IA effectiveness, discusses the implications of apparent contradictions among these, and analyses IA's potential strategies to deal with these contradictions.

7.1. Institutional forces affect IA effectiveness

Coercive force is found to be a relevant driver of change in empirical literature, so legislative and regulatory forces are a factor in determining IA effectiveness. In less developed markets, in terms of maturity of corporate governance, coercive force is recommended as a path through which to break the prevailing patterns and increase the value that IA can add. Coercive forces can be the 'door opener' to establishing an IAF. Legally mandated, clear reporting lines to the board/AC can strengthen IAF's organizational independence and help objectivity. A legal mandate is a very strong mandate, as it is reasonable to assume under normal circumstances that everyone will comply with the law. The CAE can be encouraged to operate without fear or favor. Coercive force may enable the IAF to be effective; however, it must be doubted that IA effectiveness can be formally created. It will ultimately be an outcome the key stakeholders involved may or may not provide, and we suspect that the informal dimension may play a role in that regard in some places.

Normative force requires that IA develop a distinct professional identity through which institutionalized practices may spread. However, normative isomorphism generally emerges as a weak force in empirical research, most likely because the guidance of the professional body IIA is partly ignored in practice. We understand that IA lacks exclusivity (O'Regan, 2001). IA lacks a jurisdiction, a 'heartland of work' (Abbott, 1988, p. 71), which in some cases lead IA to rely on the EA profession for its professional identity (e.g. van Peursem, 2005; Arena and Jeppesen, 2010). The weakness of the professional claim of IA poses a question for the IIA, so the IIA may want to consider ways to enhance the professional identity.

Unifying the various professional bodies, namely IIA and ISACA, may prove advantageous towards actually developing a distinct professional identity: it may provide clear guidance for IA professionals and help in managing the expectations of their stakeholders. Moving towards one combined, authoritative set of standards may increase the share of voice and its weight in the ongoing corporate governance debate, of which the IA profession is not yet a significant part (Lenz and Sarens, 2012). Abdolmohammadi (2009) recommended that the IIA emphasize the certification of membership, as, currently, anyone can sign an IA report, even those with no IA designation.

The third institutional force, mimetic isomorphism, plays an important role in IA effectiveness. We place the empirical literature that discusses the expectations of SM, the board/AC and EA into the category of mimetic forces; as such expectations exert mimetic forces on the CAE to adjust.

The existing research generally assumes that SM and the board/AC have firm expectations and that it is the IA's challenge to meet them. In the case of Sudan (Brierley *et al.*, 2001), IA's limitations become apparent when it is not wanted; although the typical IA unit in Sudan seems to be doing what satisfies the other actors involved. Such a scenario poses questions about the concept of meeting customer expectations.

IA has difficulty fully living up to expectations (Anderson, 2009) because there can be uncertainty about the value that IA provides. This situation may be partly attributable to the divergent perspectives and expectations of IA's several stakeholders - SM, the board/AC, auditees, and external auditors foremost among them. Therefore, according to Chambers (2008), it is important to 'get the boss right', that is, to define the primacy of the board/AC clearly as the chief stakeholder with oversight responsibilities, as what matters to the board/AC may then matter to SM as well. Chambers (2008) suggested that internal auditors must be independent of SM if the board is to rely on IA to provide the assurance it needs; otherwise, the risk is that IA's reports to the board/AC will be filtered by SM in such a way that only what is palatable to SM is communicated. Investing in these relationships and having a steady and robust dialogue is critical to the IAF's success, given its organizational context.

In cases where the CAE reports to the board/AC, there is an opportunity for members of the oversight body who oversee different organizations to compare and learn from best IA practices. That increases the likelihood that mimetic forces can be applied in a constructive manner.

7.2. Institutional forces may differ in levels of strengths, and they may diverge

Few empirical studies have addressed situations in which institutional forces point in different directions, or what such situations may mean for IA and how the CAE navigates in what may be a paradoxical situation. This is important because our review of the literature shows that the three types of isomorphism may draw IA in different directions or the isomorphic forces may be in conflict with other organizational demands, and that can cause dilemmas for the CAE who is trying to establish an effective IAF.

It is evident, for example, in the Sudanese case study (Brierley *et al.*, 2001) that coercive forces can be in conflict with normative forces. Corporate governance considerations are ignored, as the context is corrupt. IA is not wanted and normative forces are immaterial. That situation represents a particular challenge for CAEs, as institutional forces conflict with what is regarded as good IA practice.

In practice, there may be organizational demands, for example, budget constraints, that affect the delivery of risk-based effective IA. Consider a scenario in which a highly risky subsidiary in an international, possibly remote, location cannot be reviewed and visited on site in line with the audit cycle because of funding limitations.

Another example occurs when there is a bias towards performance, as equity providers and lenders expect returns. Performance may be given clear priority over conformance, a situation in which IA assurance services are down prioritized, and IA support is directed to render cost savings activities or revenue enhancement projects. Therefore, IA may be tasked to perform performance auditing at the expense of more assurance-related types of assignments. Hoos (2010) suggested that internal auditors give priority to either SM or the board/AC. That finding results from an experiment in which the CAE assigned the IA staff to prioritize either the management agenda (cost reduction) or the board/AC agenda (effectiveness).

In addition, little is known about the source of SM's and the board/AC's expectations. An SM with fraudulent considerations (which are not theoretical, as the many corporate scandals show) may be disinclined to benefit from the service that IA can provide. In such cases, it is unclear what the CAE can or should do. This situation again poses questions about the concept of meeting customer expectations. Or, envisage a situation in which SM deliberately wants the CAE to remove an IA subject/activity from the IA work plan. In such situations, the CAE faces a dilemma. The CAE belongs to a profession (normative force) and typically wants and needs to be a valued member of the organization, too. Such situations can be 'moments of truth' (Carlzon, 1989), situations where the CAE may or may not question SM's decisions, moments that may determine whether the CAE will ultimately succeed or fail.

As organizational contexts differ, a word of caution is appropriate when a company considers mimicking other IAFs' best practices, as doing so may not lead to satisfactory results. Contexts may differ because of organizational specifics, with politics and culture as important factors (Chanchani and MacGregor, 1999; Sarens and Abdolmohammadi, 2009a, 2009b).

What happens when isomorphic forces point in different directions, what that may mean for IA and how the CAE navigates in what may be a paradoxical situation remain central questions. Such paradoxical situations could be more frequent in practice than one might expect. There are two possible reactions to conflicting forces: organizational decoupling (hypocrisy) or institutional entrepreneurship. The following sections discuss these options in relation to IA.

7.3. Organizational decoupling or hypocrisy may be a solution in practice

Organizational decoupling is the creation and maintenance of gaps between formal policies and actual organizational practices. Decoupling may for example occur when organizations are faced with conflicts between institutional demands and practical considerations (Myers and Rowan, 1977). When used deliberately decoupling may turn into 'organizational hypocrisy' (Brunsson, 1986) as organizations respond to inconsistent norms by systematically creating inconsistencies among talk, decision and action in order to cater to the different expectations. Brunsson (1986, 1993) showed that organizations that are good at responding to inconsistent demands may live longer, so organizational decoupling or hypocrisy may serve a useful purpose.

At the professional level, IIA's apparent lack of interest in whether its members comply with its standards may be viewed as an example of such decoupling, as are other cases in which IA does not 'walk the talk'. Although such inconsistency between talk and action may be defended by claims that IA standards are in parts voluntary guidance ('strongly recommended guidance'), it qualifies as hypocrisy to the extent inconsistency between talk and action is a deliberate response to inconsistent institutional pressures. We wish to point to that possibility, and we encourage further research to evidence.

Dissonance between rhetoric and practice in IA opens an arena for further studies, building on, for example, the work of Fassin and Buelens (2011) who studied the 'hypocrisy-sincerity continuum in corporate communication and decision making'. Fassin and Buelens (2011, p. 589) noted, for example, 'that in some cases the SM … hypocritically ignore or do not want to know about the dubious practices used to achieve good sales figures'.

However, Fassin and Buelens (2011, p. 591) also pointed out 'that individuals can, indeed, make a difference'. The emergence of institutional entrepreneurship (by the CAE) is another possibility for resolving paradoxical situations, as Arena and Jeppesen (2012) have suggested.

7.4. Institutional entrepreneurship may be a solution in practice

As an alternative to organizational decoupling or hypocrisy, organizations facing diverging institutional forces may react by developing institutional entrepreneurship capacity. Battilana *et al.* (2009, p. 68) viewed those actors as institutional entrepreneurs (change agents) that '(1) initiate divergent changes; and (2) actively participate in the implementation of these changes'. To drive institutional change, the change agent may need to develop a compelling vision, mobilize people to support it, and motivate others to achieve and sustain the vision (Battilana *et al.*, 2009, p. 78); particular field characteristics and the actor's social position may be enabling conditions for institutional entrepreneurship (Battilana *et al.*, 2009, p. 87). Battilana *et* *al.* (2009, pp. 74, 84) viewed field characteristics as characteristics of the environment, or the particular context, and they viewed social capital as being associated with the actor's characteristics, including the actor's informal network and the position to influence others. The integration of interest and agency into institutional theory creates tension between institutional determinism and agency (Battilana *et al.* 2009, p. 68), a 'theoretical puzzle' referred to in the literature as the 'paradox of embedded agency' (Garud *et al.*, 2007, p. 961).

In the perspective of institutional entrepreneurship, the dimension of the CAE's personality, skills, and competencies are viewed as essential factors in IA effectiveness. There are examples of this in the literature. Albrecht *et al.* (1988, p. 6) viewed IA effectiveness as being a result of capable leadership by the incumbent CAE. Pforsich *et al.* (2006, 2008) presented a case study that emphasized the importance of the CAE when setting up the IAF. Van Peursem (2005) regarded communication skills and personal authority as indicators of successful internal auditors who are able to define their roles by adapting and tailoring them to circumstances. Leadership skills are crucial, as communication, listening, and influential skills are required when carrying out fieldwork and liaising with auditees and C-level or board executives (Chambers, 2008). Cahill (2006) presented a case in which IA identified a major issue - the malpractice of interest loading in a bank - but failed to communicate the findings clearly to the AC.

Rittenberg and Anderson (2006) presented the ideal profile of a skilled and qualified CAE, a profile that is exemplified when the CAE, in partnership with SM and the board/AC, works towards improving corporate governance and internal controls. The key performance criteria for CAEs include stature and presence, strategic audit focus, the ability to exercise sound judgment, and the capacity to communicate clearly on audit issues. Mihret *et al.* (2010, p. 240) stressed the crucial skill of being able 'to make the "tough" recommendations without fear or favor'. Similarly, Soh and Martinov-Bennie (2011, p. 614) emphasized that 'a good CAE is able to work with other stakeholders in the organization and is not afraid to voice his or her opinion even in controversial situations'. The CAE that acts as an institutional entrepreneur must present an IA value proposition that addresses all key stakeholders' expectations and problems. Possibly, institutional entrepreneurship and CAE agency could have been the way more timely alerting to the danger of mis-selling weird services and products in the financial sector. CAE agency that noticeably strengthens corporate governance and risk management in critical moments may help preventing corporate collapses. That may have required a CAE, ultimately helped by the board and others, to question and challenge SM decisions. We regard such ‘moments of truth’, moments of conflict and discomfort as highly significant, so they deserve additional attention in empirical research.

The role of the CAE, especially when he or she is interacting with the C-suite (SM) and the oversight body (the board/AC) to foster cooperation, warrants further research, especially as the empirical literature focuses on meeting top-down expectations. In addition, while CAE agency may be a rare phenomenon in practice, bottom-up agency is possible, which is a good reason to seek it out.

8. Conclusion

We see idle potential in the work of IA. A more fully understanding the macro- and micro-factors influencing the effectiveness of IA, as discussed in this conceptual paper, may help to bring the best out of IA. The macro-factors that influence IA effectiveness comprise coercive, normative and mimetic forces. Since IA is typically an internal monitoring mechanism working for internal stakeholders, the characteristics of the IAF in the respective organizational context are ultimately determined by micro factors. In cases where macro and micro forces are in conflict with each other, the CAE has to decide what is given priority.

Using the perspective of new institutional theory (DiMaggio and Powell, 1983; DiMaggio, 1988), including the works on institutional entrepreneurship as a framework, this paper provided a critical review of the existing empirical literature on IA effectiveness after the latest revision of the IA definition in 1999. It considered empirical literature that was based on internal self-assessments (mostly by CAEs) and empirical literature that studied how the clients, customers, and beneficiaries of the service rendered by the IAF perceived its value.

We found that coercive forces influence IA effectiveness and partly determine what IA effectiveness means in its organizational context. Companies and IAF seek to conform to laws to secure their legitimacy, so if having an IAF is legally required, organizations have an IAF. However, simply having an IAF says little about its effectiveness. Especially in less developed markets (in terms of the maturity of their corporate governance), coercive force is recommended to open the door for IA.

Normative forces influence IA effectiveness to the degree that IA has a professional identity and complies with the norms for professional behavior, in particular, compliance with the IIA standards. The role and influence of the CAE is critical in that regard, as the CAE is the ambassador of the IA. As the identity of IA is not sufficiently clear, that force is currently comparatively weak, which may pose challenges to the IIA.

Mimetic forces are exerted by mimicking best practices in other organizations, in particular, the way they meet customer expectations. IA has multiple customers and stakeholders, including the board/AC, SM and EA - all of whom may have differing expectations of IA's value proposition. EA views IA as auxiliary to what EA is tasked to do, that is, auditing the financial statements.

While the three institutional forces affect IA effectiveness, it is apparent from our literature review that they differ in strength, they can diverge, and they can be in conflict, either with other institutional forces or with organizational values. IAFs may react to such institutional misalignment in various ways. First, a simple response is to follow the prevalent institutions thus creating some variation in IA practice between organizations. Second, IAF's may react to conflicting institutional demands by decoupling their work from the formal organizational policy, i.e. by creating some inconsistency between what they say they do and what they actually do. Third, IAFs may use institutional conflicts or contradictions as opportunities to seize agency in order to secure local adaptation of the conflicting forces. Accordingly, we see contradictions and tensions ('moments of truth') as source of energy for the CAE[7] to potentially help IA to render a service that helps the organization to achieve its objectives by positively influencing the quality of corporate governance. To do so, the CAE as an institutional entrepreneur needs to possess political skills to gain

[7] The term CAE stands for Chief Auditing Executive, used synonymously with Head of Internal Audit.

acceptance for improved or innovative concepts “how we do things here”, for example, when enhancing or introducing risk management practices or combined assurance services. Having adequate access to the board/AC is regarded a key feature of an effective IAF since regular and timely communication between the CAE and the oversight body enables shared knowledge and common goals, and may heighten the appreciation for the IA work rendered. That can give the CAE a strong mandate to also challenge SM when that is needed.

We conclude by suggesting some questions and perspectives for research:

1) *Can the CAE become a change agent, and if so, what are the most favourable conditions for doing so?*

Institutional forces have different levels of strength and may not all point in the same direction, or they may be in conflict with the values for which IA stands. In those situations, leadership (agency) is particularly important in setting and driving the agenda. Empirical research has generally viewed agency one-dimensionally: the stereotypical model is that the board/AC and/or SM have expectations that IA tries to identify and meet. That stereotype can be challenged such that, rather than the IA serving its master or masters, the CAE may become a change agent, breaking with institutionalized practices and establishing a new pattern. That requires a CAE that also challenge SM’s decisions when that is needed.

CAE agency is suggested as a new field for empirical research, as it is reasonable to assume that driving the agenda from that perspective requires particular skills. Battilana *et al.* (2009, pp. 76, 84) pointed to the importance of ‘social capital’ (that is associated with actors’ informal network) and ‘field-level-characteristics’. Research should examine the critical success factors that would enable CAEs to emerge as agents, as personal characteristics and competences such as business acumen and technical skills, leadership skills, communication skills, listening skills, influencing skills and relationship acumen are expected to be important in liaising successfully with auditees, SM and the board/AC.

There are no longitudinal studies on CAE in empirical research, but such research may add new knowledge – or correct extant findings – to that provided by point-in-time research. Individual cases may reveal novelty, while larger-scale analyses and calculated averages may disguise what truly matters. Studies of what moments of change, such as changes to the institutional forces, newly appointed SM or boards/AC, new CAEs or new ownership, mean to the role and value of the IAF are promising. In this way, more may be learned about CAE agency and the CAE's role as institutional entrepreneur in the context of IA and corporate governance.

2) *Can internal auditors assume a more proactive role in the governance arena?*
The more the phenomenon of CAE agency is studied in practice, the more relevant CAEs (and IAFs) and the IA profession may become in the corporate governance arena. Thus, the stereotypical CAE may transform from being an actor in the specific organizational context of governance who seeks to meet others' expectations (and who is sometimes ignored or marginalized in practice) to being an agent who drives change. Bottom-up agency (CAE agency) is expected to be much more difficult to implement than top-down agency, and it may fail when the CAE hits a glass ceiling (or a brick wall) at some point. That perspective is under examined in practice, and it is ripe for further study that may break the dominant perspective that meeting stakeholders' expectations is the only way an IAF can be effective. New insights from such cases of CAE agency may prove instrumental in enhancing the curricula of IA studies and training, and may be useful in the IIA's efforts to achieve broad recognition of IA as a profession.

3) *What characterizes the comparatively more effective, and value adding, CAE?*
There is a need to clarify the necessary competencies of internal auditors, in general, and the CAE, in particular. Researchers should study situations of discomfort in which the CAE makes 'tough' recommendations without fear or favor ('moments of truth'). Researchers should also study moments of discomfort and conflict that occur when the normative guidance and organizational specifics disagree.

4) *What characterizes the comparatively more effective, and value adding, IAF?*
Qualitative research on extreme cases at both ends of the effectiveness continuum - that is, those that are comparatively more effective and those that are comparatively less effective – could lead to relevant, valuable, and novel insights. Such study requires including the perspectives of SM and boards/AC. The question concerning

why many stakeholders fail to understand the value of the IAF should be investigated at the firm level without excluding the possibility that, in some cases, there is little or no such value.

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Figure 1
Institutional forces and the role of agency (DiMaggio and Powell 1983; DiMaggio 1988), complemented by own considerations

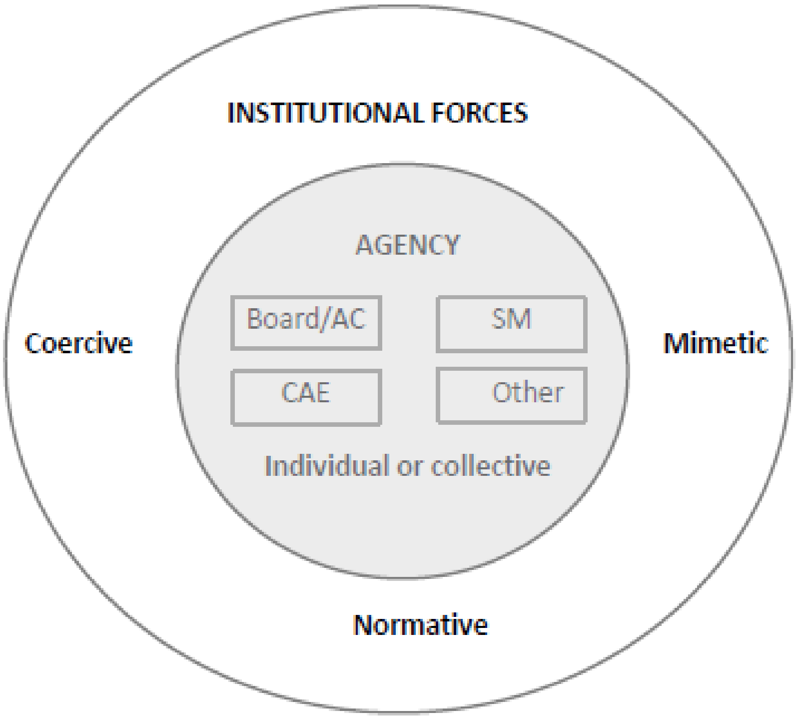

Table 1

Isomorphism and IA effectiveness

Isomorphism and IA effectiveness	Coercive force	Normative force	Mimetic force
What can we expect to find in the literature?	IA is effective when it complies with laws and other binding regulations.	IA is expected to be effective if it develops a distinct professional identity and adheres to the standards for professional performance. The stronger the normative force of the IIA the more effective the IAF.	IA is effective when there is a legitimate, institutionalized model on which to base IA.
What does the literature tell us?	Companies and IAFs seek to conform to laws to secure their legitimacy. Especially in less developed markets in terms of maturity of corporate governance, coercive force is recommended to increase the value that IA can add.	The IA identity is not clear (enough). There is lack of exclusivity. There is non-compliance in practice with the professional standards of the IIA, promulgating the way IA should look like.	Meeting customer expectations serves as useful referent of IA effectiveness. There are multiple customers and stakeholders of IA, including the board/AC, SM and external audit (EA).
What can we know?	If having an IAF is legally required, organizations have an IAF.	The role and influence of the CAE is critical.	There are multiple stakeholders who may have different expectations of IA's value proposition. EA view IA as auxiliary to what EA is tasked to do, that is auditing the financial statements.
What needs to be researched?	Having an IAF does not necessarily mean that the IAF is effective. Effective IA is not the same as value-adding IA; IAFs can be effective in non-value adding pursuit. The influence of organizational culture when responding to coercive forces. The influence of coercive force in less developed corporate governance contexts, e.g., Saudi Arabia and Sudan. Can IA effectiveness be legally requested, or is it rather a matter of "gardening"? Is IA generally more effective in an environment that legally requires organizations to have an IAF (e.g., in comparison to environments where the comply-or-explain principle is applied)?	Better understand the necessary competence of internal auditors in general, and of the CAE in particular. Study the contextual dependency of IA effectiveness by considering the influence of organizational characteristics (politics, culture). Study moments of discomfort and conflict, when the normative guidance and organizational specifics disagree. Study the influence of IIA standards as "soft text" versus "hard text". In addition, research pros and cons of setting IIA standards as descriptive codification of practice or as progressive normative standard.	Seeking to meet expectations entails challenges for IA, especially when expectations differ, when they are vague, or do not exist at all. Where do expectations come from, what affects them, how do they evolve, and what can IA do to influence them? Why is attention to IA and support from the board/AC and SM sometimes lacking? The EA perspective, where IA quality is perceived as higher when it has greater utilitarian benefit for EA, can be challenged. The three criteria (objectivity, performance and competence) are assessed based on observable indicators that can be disputed.
Literature, e.g.:	Brierley et al. (2001), Al-Twaijry et al. (2003), Arena et al. (2006), Carcello et al. (2005a, 2005b), IIARF (2007), Hermanson et al. (2008), PwC (2009), IIARF (2009), Lin et al. (2011), Marks (2012)	Abbott (1988), Burns et al. (1994), Ridley and D'Silva (1997), O'Regan (2001), Spira and Page (2003), Van Peursem (2004, 2005), IIARF (2007), Abdolmohammadi (2009), Mark and Taylor (2009), Arena and Jeppesen (2010), IIARF (2010), IIARF (2011a, c), Lenz and Sarens (2012)	Albrecht et al. (1988), Rezaee and Lander (1993), Cooper et al. (1994), Scarbrough et al. (1998), Felix et al. (2001, 2005), Goodwin and Yeo (2001), O'Regan (2001), Raghunandan et al. (2001), Krishnamoorthy (2002), Goodwin (2003), Gramling et al. (2004), Sarens and DeBeelde (2006a, 2006b), Mihret and Yismaw (2007), Rose and Norman (2008), Anderson (2009), Arena and Azzone (2009a, 2009b), Christopher et al. (2009), Davies (2009), Halimah et al. (2009), Sarens et al. (2009), Cohen and Sayag (2010), Geis (2010), Hoos (2010), Norman et al. (2010), De Zwaan et al. (2011)