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Internal Audits as a Source of Ethical Behavior, Efficiency, and Effectiveness in Work Units

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Abstract This study of internal auditors and auditees, who engage in both financial and operational internal audits in Israel, extends theory and research on internal audits in organizational units. It develops and tests a model that examines the role of top management and internal auditors in facilitating learning from internal audits and driving perceived performance improvement. We argue that support from the top management for the internal audit as well as the auditor's capacity (skills, resources, and behaviors) facilitate learning from audits and help audited units to improve ethicality, efficiency, and effectiveness in organizations. The results of time-lagged survey data provide general support for the hypothesized indirect relationships between auditor capacity, auditor–auditee relational exchanges, learning from audits, and three different perceived performance measures: ethical behavior, efficiency, and effectiveness. We discuss the implications for research on internal audits, proactive learning, ethics, and performance improvement of organizational units in the public sector.

Keywords Internal audit · Performance improvement · Auditor–auditee exchange · Learning from audits · Work units

Control mechanisms are institutionalized to provide reasonable assurance to public constituents such that the activities of for-profit and not-for-profit organizations are appropriately monitored. One such low-anchored control mechanism is the internal audit. Recent legislation (e.g., the Sarbanes–Oxley Act) points to the crucial role played by internal auditors in achieving compliance. While evaluating the accuracy of financial reports by channeling attention to detecting irregularities is vital, audits are not only concerned with regulation compliance. Rather, scholars have noted that this 'rule-based approach' is perhaps one of the most significant problems underlying the epic scandals that rocked Enron and WorldCom, because it does not incorporate a fundamental response to the issue of 'ethical principles' (Satava et al. 2006) that circumscribes the moral obligations of both auditees and auditors. A variety of problems have been identified in these cases including a lack of independence (e.g., Enron—Arthur Anderson) and fraudulent behaviors (e.g., WorldCom) that underpin the "ethical relevance" of auditing.[1]

The audit process is designed to point to deficiencies and errors in ways that help the organization to rectify or preempt their recurrence (Fayol 1949). The internal auditor assesses the extent to which auditees' actions are consistent with the law, organizational norms, and good business practice (Dittenhofer 1997). However, the internal auditor undertakes other audits including safety audits, operational audits, financial audits, information security audits, risk management, survivability and disaster recovery (DRP) audits, security and forensic accounting, and management audits. The Institute of Internal Auditors (IIA) defined the unique way the auditor contributes to this process. Specifically, the auditor helps enhance the value of the organization and improve its performance by assisting in building better governance mechanisms, and improving the risk management and control of enterprise resources and actions (The IIA 1999).

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