PSYCHOLOGICAL FACTORS OF INTERNAL AUDITORS COMMITTING CORRUPTION

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Abstract

Internal audit is an important part of modern enterprise management. The psychology and behaviour of internal auditors are influenced by their professional competence, the auditing environment and the existence of internal power. From the perspective of psychological activities, this paper aims to identify the psychological factors of internal auditors committing corruption. First, the audit environment and professional competency of the internal auditors were summed up. Then, the internal audit process was analysed based on the psychology of conformity and the herd behaviour, respectively. The results show that, when difficulties arise in the audit process, the auditors with conformity psychology are unwilling to communicate with the auditees, but tend to delay or refuse to complete their due duties; the herd behaviour is unstable and fragile: an internal audit will become vulnerable after encountering an external audit, but the herd behaviour cannot undermine the existing internal audit system. This research lays a theoretical basis for enhancing the fairness and justice of internal audit.

Key words: Internal Audit, Psychology, Conformity, Herd Behaviour, Psychological Factors.

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INTRODUCTION

In the face of economic globalization, the challenges of informatization, and the increasingly complex organizational operational risks within firms, internal audit has shown unprecedented importance (Buckman, Naismith, Saunders et al., 2018). The practical application of internal audit has made significant progress in domestic and foreign enterprises, and the status of internal audit institutions and their personnel has also been improved as never before. In real life, auditing has been carried out throughout, and auditors maintain good relations with relevant institutions and individuals (Pybis, Saxon, Hill et al., 2017). It is inevitable for the auditors to deal with people of all kinds in the audit process which is a process of continuous communication, mastering information, winning understanding, and finally reaching a consensus. The process requires effective communication to achieve the auditing (Kent, Munro, & Gambling, 2010; Russo, Crossan, Reid et al., 2011). Auditor corruption is caused by the irrational behaviour of auditors. From pre-audit to audit to post-audit, internal auditors need to communicate with departments and their personnel in their work, and corruption factors run throughout in this process (Lynch, Goodhart, Saunders et al., 2011).

The psychology of conformity refers to the behaviours that occur under surveillance. It can be expressed as three stages of compliance, identification and internalisation. Auditors are vulnerable to certain group and others during the audit process, resulting in the changes in their own values (Cameran, Ditillo, & Pettinicchio, 2017). The individual decisions of auditors are susceptible to the opinions of others, and internal pressures can also lead individuals to make decisions that are not correct in their opinions (Hurley, 2015). Herd behaviour is an
imitation behaviour, and the auditor also imitates the practices of other auditors during the audit process. This behaviour is characterized by ambiguity, uncertainty, and lack of objective criteria (Pizzi, Lin, & Ziegenfuss, 2015). Based on the two psychological activities of conformity and herd behaviour, this paper studies the internal audit process and explores the internal auditors’ psychological factors of corruption.

AUDIT ENVIRONMENT AND PROFESSIONAL COMPETENCY OF THE INTERNAL AUDITORS

Internal audit is part of the enterprise internal environment, requiring internal audit institutions to maintain independence and objectivity, as well as the sufficient organizational status and authority (Bozkus & Caliyurt, 2018). Most of China’s internal audit institutions are affiliated to the board of directors and have high independence, which enables internal audit to communicate directly with the corporate leadership, in response to direct pressure from the corporate leadership, and then leading to corruption (Yurch, Cross, Sabo et al., 2015). Figure 1 shows the factors affecting internal audit. Influenced by the internal audit environment and professional competence, the internal audit environment is related to the governance level and the business level, and the professional competence is related to the individual level.

Figure 1. Internal auditing factors

Figure 2 shows the changes in independence and professional competency time changes. It can be seen that the internal audit independence of listed enterprises in China has improved, while the professional competence of internal auditors remains at a low level. Through the internal audit, the auditors can gain a deeper understanding of the enterprise’s operational, financial and management status, making it easier to find internal problems of the enterprise. Internal audit often has a more deterrent effect on the management of fraud entities. However, due to corruption behaviours of the internal auditors, it’s not enough to achieve such an ideal effect (Kelly & Tan, 2017; Havelka & Merhout, 2013).

Figure 2. Internal audit independence and professional competency time changes

INTERNAL AUDIT PROCESS BASED ON THE PSYCHOLOGY OF CONFORMITY

Psychology of conformity

A mass of data shows that few internal auditors can maintain their initial intention and self-independence. The psychology of conformity is common to most auditors. Besides, the pressure from the superior has an important impact on the auditor’s personal consciousness (Razimah, Zubaidah, & Malcolm, 2018). In view of the auditor’s own motives, the conformity is good for better work and better interpersonal relationship. By observing other colleagues, when the auditor is influenced by those who don’t follow up others and are alienated, the psychology of conformity is easily caused. The psychology of conformity will lead to the unwillingness of the auditors in actively finding ways to communicate with the audited personnel when facing difficulties during the audit process, but to delay or shirk responsibility as much as possible and push their work that should be completed by himself to others.

Table 1 shows the division of audit information by J. Henry’s Law. Open areas and unknown areas will not attract the attention of
auditors, while the concealed areas and blind areas are the contesting focus of auditors and auditees. Communication in the contest origin in psychology, which ultimately affects and is closely linked to the psychology. Figure 2 shows the psychological activities of the auditees. Typical psychological types include psychological prevention, utilization psychology, negative coping psychology, and positive psychology.

**Table 1. The division of audit information by Jay Henry’s law**

| Others know | I know | I don't know |
|-------------|--------|--------------|
| Others don't know | Open area | Blind area |
|             | Hidden area | Unknown area |

**Table 2. Psychological activities of the auditees**

| Psychological types | Typical performance |
|---------------------|---------------------|
| Psychological prevention | Boycott against audit work |
| Use psychology | Use audit to suppress competitors or profit |
| Negative coping psychology | Don’t care about audit work |
| Positive psychology | Actively cooperate with the audit work |

**Analysis for conformity psychology in the internal audit process**

**Figure 3. The number of internal auditors and the number of low-level corruptions in a listed company**

Internal auditors use the feed-forward approach to warn the management of the risks of violations such as earnings manipulation, and actively intervene in the review of high-level earnings management, but there are inextricable interest relationships between senior management and internal audit leaders. Under pressure from internal audit leaders, the auditors may be isolated to face isolated risks if they obey professional ethics. Herd behaviour does not mean recognition, and often it is obedience. Figure 3 shows the number of corruptions for high-level and low-level internal auditors of a listed enterprise. It can be clearly seen that the corruption of internal auditors in low positions also accounts for a large proportion, and their corruption is mostly caused by the psychology of conformity.

**INTERNAL AUDIT PROCESS BASED ON HERD BEHAVIOUR**

**Analysis of herd behaviour in the internal audit process**

The root of herd behaviour is the existence of the power relationship. It will lead to the unfair problems, because the herd actors abandon their private information and follow others with certain convergence. For the internal audit, it can weaken the effectiveness of internal audit and encourage the occurrence of corruption. Furthermore, there will be overreaction after the herd behaviour exceeds a certain limit. Table 3 lists 62 cases of false information investigated in 2013-2018, involving false audit reports, false capital verification reports etc., mainly through the false, seriously misleading or major omission behaviours during the audit process. The Herd behaviour is unstable and fragile. Once an internal audit encounters an external audit, it will lead to vulnerability in the whole internal audit. However, the existing internal audit system won’t be destroyed.

**Table 3. 62 false information cases investigated in 2013-2018**

| Punishment reasons | quantity |
|-------------------|---------|
| False, seriously misleading or major omissions in the audit | 24 |
| Involved in the review report false | 8 |
| Involved in the capital report false | 5 |
| Involved in asset assessment report false | 2 |
| Involved in the profit forecast report review false | 5 |
| False, seriously misleading content in the audit process | 15 |
| Other | 3 |
Figure 4. Organizational structure of listed companies

Deep analysis of internal auditor’s herd behaviour

Figure 4 shows the organizational structure of the listed enterprise. The audit process can be carried out directly on both leaders and members. Empirical research has confirmed that there are obvious herd behaviours in the internal audit process of Chinese enterprises. At present, there exists a typical information asymmetry phenomenon in listed enterprises. In order to reduce or eliminate the asymmetry, internal audit is required. Table 4 shows the credibility of the internal audit report, for the leadership’s audit report and the enterprise’s overall internal audit report respectively, indicating that the latter report is mostly partially credible, while a large proportion of leadership’s audit reports is not credible. Figure 5 shows the number of corrupted auditors and direct economic losses of one enterprise. It can be clearly seen from the data statistics that audit corruption based on herd behaviour still exists in recent years, which brings a huge number of direct economic benefits to enterprises.

The formation of the herd behaviour is not related to the auditor’s personal ability, but to the auditor’s psychology changes in a specific environment. Table 5 lists the various abilities of the auditor’s personal qualities. The motives in his or her personal abilities determines the changes in behaviour or thought, intuitively for reputation and expectations, that is, the auditor’s herd behaviours are changed under the environmental drives, which has nothing to do with their qualities such as skills, knowledge, traits, and self-cognition etc. Rights are the main cause of herd behaviour. To achieve fairness and justice in auditing, a scientific and perfect institutional system must be constructed to monitor and supervise rights. Figure 6 shows the internal audit governance. In the internal audit process, the information transparency, separation of rights and compensation control systems should be implemented, and internal corruption must be severely punished.

Table 4. Internal audit report credibility

|                          | Personal | Mechanism |
|--------------------------|----------|-----------|
| Fully trusted            | 9.6      | 1.1       |
| Basically trusted        | 25.9     | 40.3      |
| Partially trusted        | 44.3     | 53.4      |
| Basically untrustworthy  | 17.1     | 4.2       |
| Completely untrustworthy | 3.1      | 1         |

Table 5. Explanation of each ability of the auditor’s personal qualities

| Quality ability       | Definition                        | Content                         |
|-----------------------|----------------------------------|---------------------------------|
| Skill                 | Applying knowledge in a structured way to complete auditing capabilities | Computer skills, communication skills, etc. |
|                       | Knowledge reserves and experience in the field of internal audit | Financial knowledge, legal knowledge, engineering cost |
| Knowledge             | Behaviours and styles based on attitudes and values | Experts, scholars, etc. |
| Social role           | Values and self-impression | Confidence and optimism |
| Self-awareness        | Unique or typical behaviour of an individual | Integrity, integrity, responsibility |
| Trait                 | An idea or idea that determines the stability of external behaviour. | Expect |
CONCLUSIONS

Based on the two psychological activities of conformity and herd behaviour, this paper studies the internal audit process and explores the internal auditor’s psychological factors of corruption. The specific conclusions are as follows:

(1) Under actual circumstances, due to the internal auditor’s corrupt behaviour, the auditing behaviour cannot help to find the internal problems exposed by the enterprise, nor can it have a deterrent effect on the management of the fraud entity. And the audit process is the process of contest between the auditors and auditees, in which the communication originates from the psychology, and ultimately affects the psychology and is closely connected with the psychology.

(2) Herd behaviour does not mean recognition. In many cases, it is obedience. There are extricable interest relationships between senior management and internal audit leaders. Under pressure from internal audit leaders, the internal auditor’s compliance with professional ethics will expose them to isolated risks.

(3) Rights are the main cause of herd behaviour. The investigation shows that audit corruption based on herd behaviour still exists in recent years, and a huge number of direct economic benefits have been brought to enterprises.

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