

Behavioral Aspect: The Impact of Organization Culture and Ethicality on Internal Auditor's Decision Making

¹Abdi Hussen Abdelahi, ²Dhamayanthi Arumugam,
³Kahyathri A/P Suppiah

Abstract--Organizational Culture also known as Corporate Culture is referred to a system of shared beliefs, values, and assumptions that guide people between what is appropriate and inappropriate behavior. Ethical culture of the organization developsto be a powerful tool for leaders to communicate the organizational values to all members of the organization. Leaders who develop and implement ethical culture will be followed by all members of the organization and make individual milestone to perform an action. The reassessed studies given in literature demonstrates the significance of organizational culture and ethicalities and how they impact the auditor's decision making practices as it brings about the ethical culture, leadership styles, rule of conduct and organizational artifacts and at last the way each of the components influence internal auditor's decision making.

The findings of the present study has illustrated that there are a positive relationship between the cultural and ethical factors of (Ethical culture, Leadership style, Rule of conduct, and Artifacts) with the dependent variable Internal auditor's decision making.

The present quantitative study has a significance in the area of the organizational culture and ethical development of the corporate environment and among the different perspectives that this study could be significant to includes auditor's and managements perspective as well as academic perspectives.

Key Words--Behavioral aspect, organization culture, ethicality

I. INTRODUCTION

As one of the cornerstones of corporate governance, internal auditors are expected to work with audit committees, boards and senior management to help set the right “tone at the top” and to help ensure that ethical behavior flows down through the ranks to lower level employees. Enhanced audit quality naturally derives from the auditors that are free of pressure while auditing, less work and a solid competition. (Khalid Salih and Tin Hla, 2016).

Organizational Culture also called Corporate Culture is referred to a system of shared values, beliefs, and assumptions that guide people between what is appropriate and inappropriate behavior. Ethical culture of the organization is becoming a powerful tool for leaders to communicate the organizational values to all members of the

¹ Research Scholar, Asia Pacific University, Malaysia.

²Lecturer, Asia Pacific University, Malaysia.

³Lecturer, Asia Pacific University, Malaysia.

organization. Leaders who develop and implement ethical culture will be followed by all members of the organization and make individual milestone to perform an action. (Apriliani, Anggraini ZR and Anwar, 2014).

In another research by (Wright, 2009), an examination has been made on the way organizational culture influences the use of operational internal audit and the operational internal audit response. The finding of the study was that the internal auditors having a significant cultural alignment with rules and procedures had an inclination to effectively operate in the organizations they work in. Furthermore, (Testa and Sipe, 2013) argued that with the escalation of level of competition and the demands of the customers, organizational managers are faced with the increasing issue of how to maintain their competitive advantage, to develop a compelling organizational culture being one of the methods. Therefore, organizational culture needs improvement if the organization is keen of establishing a competitive advantage.

(Kustinah, 2013) also explored the effect of organizational culture on the conduct of employees in different categories and the significance of its relationship with organizational culture in terms of determining how the latter influences the audit quality of certified public accountants. His discovery demonstrated that organizational culture positively and notably affect the quality of audit.

The reassessed studies given in literature demonstrates the significance of organizational culture and ethicalities and how they impact the auditor's decision making practices as it brings about the ethical culture, leadership styles, rule of conduct and organizational artifacts and at last the way each of the components influence internal auditor's decision making.

II. PROBLEM STATEMENT

According to a report by (CIIA 2014), it is identified the clear need to perform audits on corporate culture itself and called for internal auditors to include culture as a key part of their audit practices. This is an intense change to traditional auditing practices, which assess quantifiable parts of business, for example, stock and compliance. Moreover, despite the fact of being independent and objective, internal audit, without realizing it, may have adopted the same cultural values and ethics as the rest of the organization. This raises the issue of credibility and whether, if it is part of the culture itself, internal audit can effectively audit it.

According to (Gavin, Roy and Summers, 2010), Internal auditors appear to be performing several operating functions that should be performed by others. The performance of these functions is not in harmony with the objective of internal auditing as outlined in the Standards. Moreover, from an operational auditing perspective, there seems to be a less than desirable balance in the assignment of potential code of conduct activities/functions among corporate employees: for example, ethics committees and ombudspersons are used infrequently. In other words, there appears to be a concentration of responsibility in a few individuals or groups that are performing code of conduct activities and functions.

Ethical organizational culture is a tool for leaders to communicate about beliefs and values to all members of the organization. But it often does not affect the individual to act ethically. The concern of the impacts made by the existing corporate ethical cultures on the objective decision making process of internal auditor's has been

increasing in both managerial and academic concerns. Yet, there is a limited literature given on the area by previous researchers. Therefore, this research is intended to fill that gap on examining the impact of ethical culture on moral decision making of internal auditors. Thus, the first research question of the study can be formulated as follows;

RQ1: Does Ethical culture in the organization has an impact on auditor's decision making?.

(Woodbine and Liu, 2010) argued that there are much evidence found indicating that leader behavior impacts employees' satisfaction and motivation in the work environment. However, there has been limited research examining the impact of leadership styles on internal auditors' moral choice. The present study will try to fill the gap and initiate future interest in this area. Practically, the researchers aimed to explore the impact of leadership on internal auditor's motivation towards moral behavior. The second research question is thus drawn as follows;

RQ2: Does the leadership style has an impact on internal auditor's ethical decision making?.

Internal auditors are required to be independent, but at the same time it is depending on the needs of their clients because of the fee received. This will continue especially when the results of the auditor's findings are not in accordance with the expectations of an audit client that raises conflict (Tsui and Gul, 1996 in Budi Saso, 2004). This audit conflict will develop into an ethical dilemma when the auditor is required to make decisions that are contrary to the independence and integrity with economic rewards that may occur or pressure on the other side (Windsor and Ashkenazy, 1995 in Budi, 2004). Dilemma is what ultimately causes the auditor to act deviant and unethical act. Research in KoroySchuetze (2007) even said that many auditors acts to serve or to advocate for the interests of the client instead. Thus the third research question is formulated as follows;

RQ3: Does the organizational artifacts impact on the internal auditor's decision making?.

Code of Conduct which has been used as a crutch to uphold healthy practices that are free from fraud does not seem strong enough to face the properties of "selfish" economic greed and selfish of each businesses owner. The existence of code of conduct is also not the only reason to act ethically for accountant. It appears that the implementation of a process to ensure the effective operation of codes of conduct are still in a more basic or formative stage. It is hoped that internal audit practitioners and students are assisted by the process that has been described here and the problems that have been identified in operationalizing a code of conduct. The fourth research question of the study is hence formulated as follows;

RQ4: Do the rule of conducts in the organization have an impact on the decision making of internal auditors?.

III. RESEARCH OBJECTIVES

Objectives of the present research are as follows;

- To study the level of impact of ethical culture on internal auditor's decision making.
- To identify the level of impact of rule of conducts on the decision making of internal auditors.
- To find out the impact of leadership style on the internal auditor's decision making.
- To find out the relationship of organizational artifacts with internal auditor's decision making.

IV. RESEARCH METHODOLOGY

The theoretical framework (Exhibit 1) in this present study aims to identify that the independent variables of ethical culture, leadership style, rule of conducts and organizational artifacts has direct interaction with the dependent variable namely internal auditor's ethical decision making.

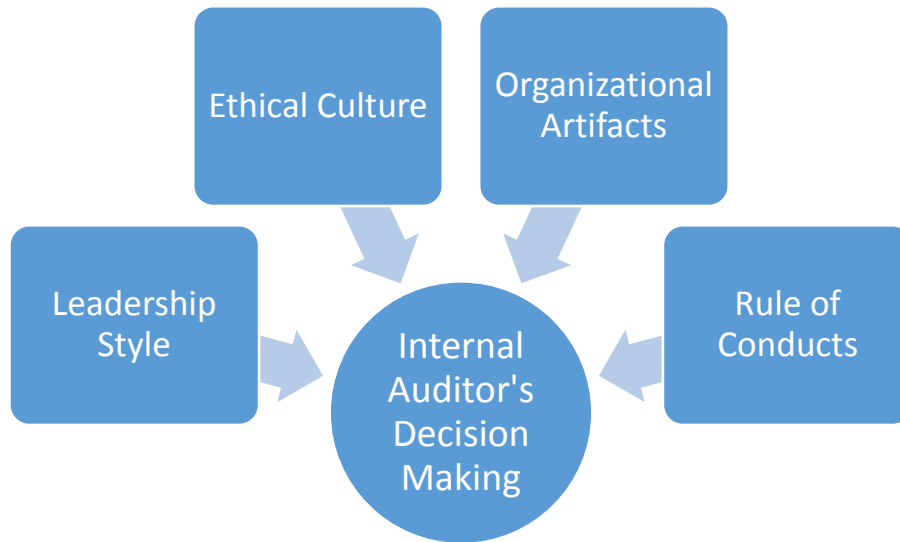


EXHIBIT 1: Research framework

Quantitative Research Method with primary data collection are applied in this research. Electronic questionnaires are being used in this research as the participants of the research are computer literate. Then the questionnaires will be sent to the respondents of employees in private sectors. Multiple linear regression model is being used in the present research to investigate how the organizational culture and ethical factors affect the decision making process of internal auditors via SPSS.

Therefore, the relationship of the dependent variable with the independent variables can be formulated as in the following equation;

$$Y = B_0 + B_1 X_1 + B_2 X_2 + B_3 X_3 + B_4 X_4 + B_5 X_5$$

In this research,

Y = Internal auditor's decision making (Dependent Variable)

X₁ = Ethical culture (Independent Variable)

X₂ = Leadership style (Independent Variable)

X₃ = Rule of conducts (Independent Variable)

X₄ = Organizational artifacts (Independent Variable)

V. FINDINGS

TABLE 1: Model summary

Model Summary				
Model	R	R Square	Adjusted Square	Std. Error of the Estimate
1	.551 ^a	.304	.260	0.46
a. Predictors: (Constant), Artifacts, Ethical Culture, Leadership style, Rule of conduct				

Source: primary source

In this section, the overall model summary is presented. Table 1 indicates the summary of the model including r, r² and adjusted r². Generally, correlation coefficient (r) illustrates the relationship among dependent and independent variables where r² indicates how many of dependent variable variation is explained by the variables that is included in the model. Finally, adjusted r² is used to compare the models that have different independent variables. However, the result of adjusted r² does not interpret here since the output contains only one model. The results of r and r² are 55.1% and 30.4 % respectively. To illustrate, the correlation relationship between regressand and regressor is been assumed to interval between - 1 to + 1 such that if the outcome is negative, the correlation is negative, if the output is positive, the variables are positively related and if it is equal zero, that indicates there is no such a relationship. Here, the SPSS outcome confirms positive relationship at 55.1 %. Besides, the degree of variation of the endogenous variable that explained in the model is 30.4 %. to clarify, 1- r² that is Coefficient of non-determination. thus, Coefficient of non-determination is 69.6 % which means the dependent variable is explained 69.6 % in other variables that is not included in the model.

TABLE 2: Anova

Model		Sum Squares	df	Mean Square	F	Sig.
1	Regression	5.684	4	1.421	6.89	0.00 ^b
	Residual	13.029	63	.207		
	Total	18.712	67			
a. Dependent Variable: Internal auditor's decision making						
b. Predictors: (Constant), Artifacts, Ethical Culture, Leadership style, Rule of conduct						

Overall, the analysis of variance is assign to show the fitness of the model. In other words, if F-statistics is significant, the model is overall healthy and fit and vice versa. As consequences, the most crucial in table 2 is F-statistics or F- ratio. The F-statistics is calculated by dividing the sums of squares by the associated degrees of freedom ($1.42/0.21 = 6.89$). The p-value is equal zero that indicates the ANOVA is significant at 1%.

TABLE 3: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.713	.507		3.377	.001
	Ethical Culture	-.059	.098	-.075	-.597	.553
	Leadership style	.422	.155	.424	2.722	.008
	Rule of conduct	-.191	.142	-.211	-1.344	.184
	Artifacts	.423	.141	.411	2.988	.004
a. Dependent Variable: Internal auditor's decision making						

Source: primary data

The previous section is presented the goodness of the model. However, the ANOVA doesn't indicate the impact of independent variable on dependent variables individually. This section is design to illustrate the slope of variables and the intercept. Also, the significance of the coefficients is discussed here.

To simplify table 3, the researcher rewrite regression equation as following:

$$\text{Internal auditor's decision making} = 1.713 - 0.059 \text{ Ethical Culture} + 0.422 \text{ Leadership style} - 0.191 \text{ Rule of conduct} + 0.423 \text{ Artifacts} + U$$

The intercept (Y intercept) of above equation is 1.713 which means if the all independent variables is assumed as zero (when X-axis = 0), the internal audit decision making will be 1.713. the p-value of intercept coefficients (B0) is 0.001 that is significant at 1%. Leadership style and Artifacts both have positive impact on Internal auditor's decision making at 0.422 % and 0.423 % respectively. in addition, both are highly significant at 1%. however, the Ethical Culture and Rule of conduct both showed negative and insignificant impact on Internal auditor's decision making.

VI. CONCLUSION

Based on the significance academic and practical consideration got by the organizational or corporate culture in the recent history, there has been a massive pulled arguments among mainly the researchers contributing into the literature of the topic. For instance in the literature we have made discussions about to main ethicality corporate culture factors namely ethical culture, leadership style, and Artifacts of the organization, and rule of conducts which are all as given in the hypothesis positively impacting the decision making of the internal auditors in the organization.

There is an ethical organizational culture influence the ethical decision making in a positive way. That is, the higher the applied ethical culture within the organization (in this case-auditors of private limited firm), then the probability of a more ethical choice for internal auditors in each step decision-making process. That decision making has moral dimension such as moral awareness, moral judgment, and moral intent to be ethical behavior.

Controversially, there are vivid points among the researchers of the area which relates the ethical culture of the organization negatively to the behaviors of the members of the organization. The study also concludes that ethical culture and leadership style of the organization negatively influences the internal auditor's decision making.

On the other hand, the more often the leadership of ethical behavior applied, the more lack of tolerance and compromise against unethical behavior within the firm, the firm reprimands, and sanctions (punishment) to the auditor (either unethical behavior that lead to personal interests or the interests of company). Then the auditors will increasingly have the awareness, judgment and moral intention in any decision making. Conversely, the more often act less ethical leaders, the more often unethical behavior being tolerated and the lack of sanctions for unethical behavior. Then it will lose consciousness, judgment and moral intention for auditors to act ethically in the decision making process.

Also, there is a positive effect between variables of Rule of conduct on ethical decision making of internal auditors. If the elements of rules of conduct integrity, objectivity, confidentiality and competence are higher than the self-interest, company profit, and efficiency in the practice of the firm, then the probability of the ethical decision-making done by auditors will also be higher.

Finally, there is also an influence in the variables of organizational artifacts being part or sub set for the major organizational culture variable with the internal auditor's decision making as it has been discussed above and produced as a result in our current study, it's seen that there is a positive relationship between the organizational artifacts and the performance of the internal auditor's decision making process.

VII. RECOMMENDATION

The internal audit function (IAF) is evolving from its traditional oversight function to one that includes a wider spectrum of activities that add value to their organizations. In addition, economic pressures have forced many companies to consider outsourcing as an alternative. These ongoing changes have caused some concern regarding the potential lack of objectivity and independence for internal auditors. This explanatory study examines whether outsourcing of the internal audit function is susceptible to client advocacy vis- a`- vis in- house auditing, which itself may be sensitive to an employer advocacy.

The present quantitative study has a significance in the area of the organizational culture and ethical development of the corporate environment and among the different perspectives that this study could be significant to includes auditor's and managements perspective as well as academic perspectives.

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