Internal Audit, Internal Control and Organizational Culture

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DECLARATION

I, Ronald MacEwan Wright, declare that the PhD thesis entitled Internal Audit, Internal Control and Organizational Culture, is no more than 100,000 words in length, including quotes and exclusive of tables, figures and appendices, bibliography, references and footnotes. This thesis contains no material that has been submitted previously, in whole or in part for the award of any other academic degree or diploma. Except where otherwise indicated, this thesis is my own work.

ABSTRACT

For over a century the role of the internal auditor has been recognized as a special role within organizations that provided important support to the organization. The importance of this support has been growing over the century. In particular internal audit is considered to encompass the audit of both operational activities as well as purely financial activities.

During the last few years there has been a growing interest in organizational culture. The purpose of this study is to look at the organizational culture of organizations and their internal audit operations from the perspective of operational audit. The study will use an organizational cultural model to see if operational internal audit has identical cultural to the organization, and if not what differences exist, and how these differences might be seen to mean that the operational internal audit with a particular cultural profile better achieves its goals, and assists the organization as a result.

In conducting this study, because of the need for richer in depth data than could be achieved with a survey analysis, a multiple case approach has been taken. Three organizations within the same economic sector were examined to see how culture affected their use of operational internal audit, and how the operational internal audit responded.

The results suggest that the operational internal audit of organizations generally have their own cultural orientation, and these orientations are independent of the organizations' own cultural orientations. Further the results suggest that operational internal auditors with a strong cultural orientation towards rules and procedures will better serve their organizations.

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1.1 A Brief Outline of the Social Role of Auditing

Auditing is seen as a means of protection. Small businesses are generally managed by their owners, who are well aware of what is happening within the business. As businesses grow, the close control that the owner/managers are able to give the business becomes more difficult. Once an organization becomes too large for the direct monitoring of the critical aspect of the organization's activities by the principals of the organization, some form of additional monitoring will be required. This is generally described in most modern literature as "audit". The form and nature of this "audit" is driven by how it is appointed. If the appointment is driven by the needs of government regulation, to keep shareholders informed, then the appointment is considered to be that of an external audit (www.asic.gov.au 2005). There are, however, other influences on organizations that may lead to the appointment by the organization of "internal auditors".

The duties of the internal auditor are set by management. Internal auditors have become so numerous now that they have formed a professional body, the Institute of Internal Auditors (IIA). As with most professional bodies of employees the IIA supports its members by laying out professional guidelines that cover the roles an internal auditor should undertake. The IIA holds that internal auditors are appointed by the management of an organization for a "number of purposes" (IIA 1999). These purposes include ensuring that information generated by the organization and delivered to management is accurate. The internal auditor is also required to ensure the organization is properly protected from its business risks (IIA, 1999) or at least is making informed decisions about these risks (Ernst & Young 2006). The IIA would consider that internal audit is a comparatively wide brief encompassing a wide range of activities beyond simply verifying the books of account for management (IIA, 1999).

The firm that employs an internal auditor has generally reached a size where the senior management can no longer observe all the key operations. Thus, the internal auditor is appointed to gather information about the integrity of the operations of the company and report back to management. The nature of this information and the breadth and depth of the internal audit brief will be set by senior management, or in a growing number of organizations, at board level. Thus, the brief may be relatively confined or very broad. The IIA sees the role as a broad one, thus, it is possible that roles to which management or the board in one company give a special title, would be seen in another company or by the IIA as an internal audit role. For example, the IIA handbook includes within the scope of work that an internal auditor may perform the following: "review of quality of performance". Thus, one firm may have a Quality Manager, who performs identical tasks to those assigned to the internal auditors of another firm when they undertake a "Quality Audit".

Larger organizations will, over time, develop internal peculiarities within the organization that make it unique in the way it is both seen by the world and sees itself. Thus, there will often be specialist monitoring roles that fit the description outlined above. For the purposes of this work, such specialist monitoring roles will be considered as belonging to the internal audit function regardless of how the organization may regard them.

1.2 A Brief Introduction to Organizational Culture

Since time out of mind (as the old Saxon saying goes), mankind has organized for collective advantage. At the micro-level such organizing has today lead to the firm or corporate entity. So today, when we talk of organizations we generally talk in terms of business entities. It is with that concept in mind that organizational behaviour has come to be associated with the social or group behaviour of individuals who see themselves as members of a particular corporate organization. These simple economic organizations vary in size from a small group to many thousands of people, who may simultaneously be members of several different organizations, each of which will influence the attitudes and values of the group. Generally, this type of social interaction is considered to be organizational culture and has been the province of anthropologists and sociologists. Today, however, accountants have started to consider the influence that these attitudes and values have on the production and use of accounting information (Macintosh, 1994, Kloot, 1997). Thus, accountants have expressed growing interest in the influence of the culture of an organization on its behaviour and the effect that this behaviour has on the financial accounting operations of the organization. Accountants are recognizing that any activity of the organization will have an effect on the accounts. For example, the ability of an organization to maintain higher quality standards than its competitors will effect how well that organization is accepted within its market and therefore how successful it is within its chosen industry.

1.3 An Introduction to the Concept of the Organizational Sub-Culture

If organizations have defined cultures, what about the organizational sub-unit. Hofstede (1980) identified differences in culture in sections of the same organization located in different countries. Hofstede (1980) found that several sub-cultures could exist in an organization. Using the model he developed, he considered these sub-cultures from an international perspective, and recognized that offices of his chosen international organization located in different countries exhibited different sub-cultural attributes, while acknowledging the dominant culture of the corporate entity (Hofstede 1980). Other writers, for example, Langfield-Smith (1995) have found similar sub-cultures. Thus, it is clear that different groups within an organization will have different sub-cultures. At the same time, the organization will tend to have a dominant culture. Accordingly it is likely that the internal audit role will have a sub-culture. This study of the internal audit role will examine the development of a separate-sub-culture by the internal audit role of an organization.

1.4 What is the Role of the Sub-Culture of the Internal Auditor in Contrast to the Role of the Organization's Culture.

If the foregoing is accepted, then six key questions arise:

(1) Does the internal audit section within an organization have an organizational culture identifiably distinct from the culture of the organization within which it operates?

(2) If the internal audit section within the organization does have an organizational culture distinct from the culture of the organization within which it operates, what types of differences exist?

(3) Is the culture of the internal audit section influenced by the culture of the organization as a whole?

(4) Do the cultures of the different internal audit sections in different organizations have commonalities that exist despite the organizational cultures of different organizations being different?

(5) Do these differences lead to tensions within the organization?

(6) If so are these tensions likely to be destructive or productive?

In this context, a destructive tension would be taken to mean a tension that leads to damaging outcomes for the organization, a productive tension leads to improved outcomes for the organization.

These above questions will form the basis of the research questions to be addressed by this thesis.

1.5 The Expanding Role of the Internal Auditor and How Culture Will Influence the Way the Internal Auditor Carries Out This Role

There is a general view held both by the chief executive officers (CEOs) and the internal auditors of those organizations with an internal audit operation that the internal audit function has a broad responsibility to ensure that an organization's internal controls function properly (Mathews et al. 1993). This responsibility covers the controls designed to manage and provide information on all aspects of the business from the controls over the level of risk in business undertakings through to controls designed to ensure the basic accuracy of financial reports. The role of internal audit is expanding and will continue to do so if professional bodies such as the Institute of Chartered Accountants in Scotland are successful in implementing the suggestion that internal audit be charged with the certification of the accounts, and external audit with a certification that the internal audit function is being properly carried out (McInnes, 1993).

To carry out such a wide brief successfully, the internal auditor must be able to interpret and adapt to the culture of the organization. At this stage, while the literature regarding organizational culture is expanding, how, given the expanded role mentioned above, the internal auditor fits within the cultural model of organizations has not been carefully considered. Some work has been done to develop a method of drawing the auditee into the audit process using a process which is called by the self-explanatory name “control self-assessment” (CSA). In simple outline, this activity involves auditees assessing the controls they are facing and recommending improvements.

Thus, the development of a tested model which will measure the effect of the interplay between the culture of the organization and the culture of the internal audit operation is required if organizations are to maximise the benefits of the internal audit operation.

Further, this model must cover the relationship between organizational culture, internal control systems and the internal audit operation. An understanding of the organizational cultural interplay between different sub-cultures and the organizational culture is necessary to determine ways by which the organization may maximize the benefit of internal audit. Internal auditors need to understand their role and 'fit' within their organization and match their perceptions with the perceptions of others within the organization to maximize the benefit to the organization of an internal audit.

1.6 The approach taken in examining the fit of organizational and audit cultures

As a start in examining this aspect of organizational culture, in Chapter 2 the literature surrounding both the nature of organizational culture and the nature of audit is examined. Chapter 3 will look at the literature surrounding models of organizational culture, and discuss the most suitable model to use in analyzing questions about the role of organizational culture and the nature of internal audit. Chapter 4 will look at the literature about internal audit and discussions of its effectiveness. Chapter 5 will discuss the choice of methodology in examining an organization's culture and its internal audit function. Chapter 6 will examine selected organizations and classify these organizations by culture using the chosen cultural model outlined in Chapter 5. The relationship between the internal auditor and the rest of the organization will then be examined to demonstrate how hypotheses developed from the four questions set out above can be tested in Chapter 7. The conclusions will be elaborated on in Chapter 8 by taking the six key questions and discussing the extent to which the results of the study provide answers to these questions, together with an outline of possible directions of future research. The aim of the research is to provide a model that would provide guidance to the cultural relationship between the organization and the internal audit function.

CHAPTER 2.

THE RELATIONSHIP BETWEEN CULTURE, CORPORATE GOVERNANCE AND THE ROLE OF THE INTERNAL AUDITOR

2.1. Corporate Governance and the role of the Internal Auditor

Corporate governance is a generic term covering how a corporation is managed. It includes such things as the duties of individual board members and Boards as a whole. Part of the ambit of corporate governance is the formation and membership of Board Committees. One such committee is the Board Audit Committee which is normally charged with the oversight of how the company deals with audit. The Board Audit Committee has grown out of the rules of certain stock exchanges covering corporate governance of companies listed on those stock exchanges (www.nyse.com, 2005). Since such events as the collapse of Enron Corp. in the United Sates of America and the failure of HIH in Australia, "corporate governance" has become a buzz word around Board rooms across the world. Yet while Boards pay lip service to the new regime, it is business as usual (www.trinity.edu/rjensen, 2005). An example of this is the failure of all Board Audit Committees in the United Kingdom to use the internal audit as a tool of the Board. The Institute of Internal Auditors – United Kingdom and Ireland Branch surveyed 144 organizations with a Board Audit Committee and discovered that about 77% of Board Audit Committees consulted with the internal audit function of the organization about how the organization was run and handled its risks (Salierno 2002). Thus nearly a quarter of organizations did not use internal audit to provide feedback to the Board on how the organization was run and what risks it faced. The situation is worse in

Australia, at least in 2006. In 2006, Ernst and Young in conjunction with the IIA conducted the third annual benchmarking survey of trends in Australia and New Zealand Internal Auditing. This survey found that 64% of respondents stated that internal auditors reported to the Board, or Board Audit Committee (Ernst & Young et. al., 2006). The survey received 209 responses.

This means currently the corporate governors of 36% of organizations do not utilize the internal audit as a means of gathering information to support their corporate governance activities.

When considering the reasons organizations collapse, Enron Corp is an example worth noting. Enron Corp. was one of the largest energy trading companies in the world. Based in Texas, Enron Corp. was considered to have an exemplary corporate governance regime, even meeting the tough standards in this area set for the company to be approved as a potential investment by the Californian Government's administrative system for managing government retirement funds, the Californian Public Employees Retirement System or CalPERS (Hala . 2003). Yet, despite the compliance with corporate governance rules on the surface, the organization did not have any worthwhile corporate governance. Thus, the CEO and other senior executives were able to conceal significant problems from some members of the Board and the general public. This raises the question, what was it about the nature of Enron that caused it as an organization to take this "conceal our difficulties from the general public" approach? Put another way; what systemic systems failures caused this to happen?

A major writer in the area of systemic failure is Professor James Reason.
Reason has pointed out that there is never just one cause of a system failure. There are always several causes of a system failure. The prevention of only one of the causes will interrupt the chain of events that leads to the failure (Reason, 1990).

So how were all the systems in place (at least in the surface) to ensure good corporate governance at Enron Corporation bypassed? It would appear that over time, a number of key controls such as the budget system were corrupted in the interests of profit (Hala, 2003). A number of the very capable members of the Enron management found that the management remuneration schemes (like those in many other organizations) rewarded the persons running those sections of the organization that appeared most profitable, and (in the case of Enron Corp.) punished cautious and, therefore, apparently underperforming management (Hala, 2003). Thus, a middle to senior executive either had to appear to perform, or face being dismissed. The skilful were able to manage the data to achieve the appearance of profit, regardless of the real situation (Hala, 2003). This generated a culture that ignored reasonable controls in the interest of publishing higher and higher profit figures, those that opposed the process were removed (Hala, 2003).

What were the Board members doing at the time to maintain good governance? The Audit Committee remained, in order to satisfy the external appearances of good governance, but was considered by the Board to be less important than the Performance Review Committee. The Performance Review Committee was the part of the Board that determined executive remuneration. It considered that it was all about making money. To the Board members this seemed more important than good governance. Further, as a cost cutting exercise, the internal audit was contracted out to the external auditors; Arthur Andersen LLP. At the same time, the consultants at Arthur Anderson LLP gave direct management advice on procedures relative to the movement of profit and loss figures within the organization that would assist management to present a better picture to the Board than reality. Further, Arthur Andersen LLP avoided the potential advantages of maintaining an independent internal and external audit that may have been possible if the internal and external audit were segregated, by using an integrated approach to the external/internal audit operation. The result was that both the external and internal auditors were unable to report with proper independence. The major problem, therefore, was that management was encouraged to present a rosy picture of profits regardless of reality and was permitted to bypass any controls that may have prevented them from presenting such a fictitious picture. The externally provided internal audit was not in a position to prevent this from happening.

Having contracted out the internal audit role, as a cost saving measure, Enron Corporation senior management re-established a small internal audit operation to oversee specialist areas in the organization, where constant monitoring was required (Hala, 2003). Sherron Watkins was involved in this reconstituted internal audit, as a senior member (Hala, 2003). She noticed that Enron was managing its potential future liabilities in a manner that concealed the true risk in that area from outside users (Hala, 2003).

Sherron Watkins, when speaking about her version of the reasons behind the failure at Enron Corp. states that the lack of an internal audit that was independent of the external auditors, and the culture at Enron Corp. were two of the important drivers of the erroneous decisions behind the collapse of Enron Corp. (Hala 2003). The former did this by limiting the flow of unbiased information to the Board. The latter did it by promoting the idea that the way to success lay in developing systems that hid bad news from and promoted good news to the board.

A similar series of problems can be identified within the failure of HIH Insurance Limited, a major Australian insurance company which failed in part because the company failed to allow properly for claims under its insurance obligations. Here the company's senior management and a number of the Board members were encouraged to be selective in the use of actuarial data, such that the best possible picture of future liabilities was presented. This caused the company to undervalue its future liabilities. Thus, over time, funds that should have been put aside to meet these future liabilities were taken as profit and, eventually, distributed as dividends.

The importance of corporate culture is emphasized by a number of other writers. For example, in its report on the HIH failure, the Royal Commission into HIH stated that the culture of HIH Insurance Ltd played a role in the late discovery of the problems of that organization (Royal Commission into HIH, 2003).

The importance of controls in protecting an organization is seen through the research of practitioners such as the Forensic Accounting Section of KPMG (KPMG internal seminar, 2000). As will be discussed later, though, management accounting researchers are now paying more attention to the effect an organization's culture has on controls (Langfield-Smith, 1995, Kloot, 1997). They do not, however, discuss the relationship between the corporate culture, and the culture of those who would normally be responsible for the development of internal controls – the internal auditors.

2.2 A Brief Outline of the Development of Internal Audit

The internal auditor has been part of the business environment for some considerable time, the IIA having been formed in 1941 (www.theiia.org, 2006) but auditing and internal auditing predate that event. There are few older publications which summarize the development of the role of the internal auditor. One of the more authoritative texts on auditing from the 1960s is Irish (1966). Irish (1966) defined internal auditing as being auditing undertaken by an employee of an organization. This "employee conducting auditing activities" is not a strict definition of the internal auditor but was probably the best definition until quite recently when public accounting firms began to offer contract internal auditing services. It was however, the definition chosen by Irish (1966) as the basis of classification in separating internal and external audit. Using this basis, Irish noted that an audit-type role, undertaken by various employees, is mentioned in English documents as far back as the 11th century (Irish 1966). By the middle of the 19th century, corporate reports often mentioned internal auditors and described their function (Irish 1966).

Irish (1966) means internal audit is older than the modern concept of external audit. While some public companies incorporated before the establishment of the first modern companies act were required to have external auditors, others did not. For example, the Union Bank of Australia (a forerunner of the ANZ Bank) had no external audit until 1892. During 1892, a property market collapse led to a run on Australian and, in particular, Melbourne-based banks. The Board of the Union Bank discussed the potential for external auditors to improve the public perception of the quality of the bank's published accounts. The Board considered that the internal audit was quite adequate, and that external auditors would be redundant (ANZ Bank, Archivist, Extract of Union Bank Board Minutes for 1892). Even after the acceptance of an external audit, the Union Bank of Australia maintained a vigorous internal audit function with "Inspectors". These inspectors combined two roles. The first role was to establish that the bank's records were being properly maintained. The second role was to confirm the quality of the bank's lending portfolio (ANZ Bank Archives). The ANZ Bank (created in 1951 by the merger of the Union Bank of Australia, and the Bank of Australasia) continues to have a strong Internal Audit function (ANZ Bank, 2005).

In England during the latter part of the nineteenth century, and the first few years of the 20th century, a belief that to audit an enterprise adequately the auditor needed to be independent of the enterprise resulted in David Lloyd George, as Minister for Trade, persuading the government of the day that the matter required legislative changes (R. Lloyd George, 1960). This resulted in a series of changes to the laws relating to corporations which introduced the requirement of an external audit during the years 1897 to 1906 (Edwards, 1980). With a few exceptions, Australian legislation followed British legislation (Lipton & Herzberg, 1993 pp 1-5). For example, in Victoria, in 1907, following this tradition, the *Companies Act, 1907* was enacted. This brought Victorian corporations law in line with the British law existing at the time in that it required the appointment of suitably qualified external auditors.

The internal auditor did not disappear with the introduction of the external auditor. As pointed out before internal auditors continued to play a primary role in the auditing of a number of organizations, in particular the Australian banks. Internal audit has continued to prosper as more organizations have grown to the point where senior management have no longer been able to observe all aspects of their corporation's activities. Thus, currently, some 400 Australian organizations have some form of internal audit (Mathews et al 1993). Cooper and Craig (1984) conducted a survey of the role of corporate internal audit within large businesses in Australia. This survey was repeated in 1993 to discover what had changed in the ensuing years (Mathews et al 1993). These surveys indicated that the activities of the internal auditor are controlled by management. However, generally, the surveys revealed that internal audit was considered both by the CEOs and internal auditors to include involvement in the design and monitoring of the internal control system. Beyond that point, managers did not appear to hold a consistent position as to the role of internal audit. Given that managers may respond differently within different organizations to the reconciliation of the roles of different members of the organization, the fact that the role of internal audit appears to vary between organizations is to be expected. The reasons behind this lack of uniformity are not considered in the current literature covering internal audit (Mathews et al 1993).

Thus the question; "What are the reasons underlying this lack of uniformity?" is left for further investigation. The questionnaire used by Mathews et al (1993) did not contain any question designed to investigate this point. Nor did it contain any questions directly aimed at identifying the culture of the organization using any cultural model. In discussion, Mathews in 1999 indicated that an attempt to identify the culture of either internal audit or the corporation under examination, or to investigate any match between the two, was not considered in this research. It was stated that this was because it was considered that cultural differences would not directly influence either how an organization's internal audit was managed or the level of importance an organization assigned to the internal audit.

Internal auditors continued to play a role in a number of organizations even after the introduction of compulsory external auditors in the first half of the 20th century. Following the stock market collapse of 1929 in the USA the role of the external auditor was expanded. During this period, the quality of audit generally, and internal audit specifically, came under increased scrutiny. As a result, the Institute of Internal Auditors was established in 1941 in the USA to act as a professional body for the internal auditors (www.theiia.org, 2006). The aim was to provide the usual services such a body provides to the members of a profession. Since that time the IIA has acted as the leading professional body for internal auditors around the world. The organization has established branches world-wide including Australia. The Institute of Internal Auditors (IIA) considers the development and monitoring of controls and control systems to be one of the major roles of the internal auditor (IIA Handbook 1997).

2.3. The Role of the Internal Auditor as support for the Director's duty to be informed

The Research Foundation of the IIA has developed a new definition of internal auditing, this new definition was accepted by the IIA's Board of Directors in July 2007. In it internal audit is defined as:

> *"an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."*
>
> (www.theiia.org April 2008)

This replaces the older definition

> *"…an independent appraisal function established within and organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel, and information*

> *concerning the activities reviewed. The audit objective includes promoting effective control…"* (IIA handbook, 1997 Page 3.)

Either definition gives the internal auditor a wide ranging brief. As a result, many organizations that incorporate some form of internal audit role into the organization often sub-divide that role. Thus, in the late 1960s and early 1970s, a major Australian trading bank divided the functions between an "Internal Audit Department" responsible for monitoring the organization's record keeping and other general activities, a "Lending Inspection Department" responsible for the monitoring of lending and lending risk and an "EDP Systems Control" department to monitor the use of the bank's computers. The monitoring of EDP operations later became part of the responsibilities of the "Internal Audit Department" (ANZ Bank archives).

The ability of management to set and, therefore, to alter the roles of internal auditors indicates the main weakness of internal auditing. Internal auditing is an operation within an organization, generally undertaken by staff (employees) of the organization. Thus, it is often treated as a management function and, if treated as a line management function, may not be able to operate with an adequate level of independence. Reporting to lower levels of management is not uncommon (Mathews et al. 1993). This removes much of the "independence" of the internal auditor. Thus, the first part of the IIA definition of internal audit, above, does not apply in many situations.

Yet, since at least *Morley v Statewide Tobacco Services Ltd.* (1992) 10 ACLC 1233, it has been recognized by the courts that directors are expected to know what is going on in the company. Further, in this case, the excuse that the CEO said “X” was not sufficient to justify acceptance of “X”. This implies that directors (particularly non-executive directors) have a duty to discover the truth about a company and not simply rely on what they are told by the executive members of the Board. Given this state of affairs, and the promotion by various stock exchanges of “Board Audit Committees”, it appears that the most logical position for non executive-directors to take would be to have the Board Audit Committee require that internal audit report to that committee. As well as protecting the independence of the internal auditor, this would provide the non-executive directors with a relatively independent source of information about what is going on in the organization.

In order to guarantee unbiased information, the internal audit function would have to be protected by the Board. Yet from discussion with internal auditors this does not appear to be a widespread situation. Thus, there is little evidence that the situation revealed by Mathews et al (1993) has changed. Boards do not appear to have responded to the judgment in Morley’s case. In 2002 I interviewed several company directors who held directorships in a wide range of listed public companies in Australia. During these interviews, the majority of directors indicated that they took the view that the only solution available was to increase the director’s liability insurance cover and hope for the best. In fact, one director stated that directors relied on what was put to them by management and that in well run companies that should be sufficient for a director.

The Report of the Royal Commission into the collapse of HIH Insurance indicated that the Board Audit Committee of HIH did not at any time consult with either the internal auditors or the external auditors. In fact, it appeared that the Board Audit Committee was established in name only, simply to meet the requirements of various stock exchanges and investors (Royal Commission into HIH, 2003).

A recommendation as to the detailed role of the internal auditor was set out by the IIA in their member's handbook in 1997. In summary, the roles cover the following areas:

- ensuring the reliability and integrity of information within the organization
- ensuring compliance of members of the organization with policies, plans, procedures, laws and regulations
- safeguarding the organization's assets
- assisting the organization to use its resources efficiently and economically
- assisting the organization to accomplish its goals.

(IIA Handbook 1997 paraphrased)

Since then the role has been redefined by the IIA, with far more emphasis on risk and control. This has caused the IIA to rewrite their view of the detailed role of internal audit to be:

2110 - Risk Management
The internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

2110.A1 - The internal audit activity should monitor and evaluate the effectiveness of the organization's risk management system.

2110.A2 - The internal audit activity should evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the

Reliability and integrity of financial and operational information.
Effectiveness and efficiency of operations.
Safeguarding of assets.
Compliance with laws, regulations, and contracts.
2110.C1 - During consulting engagements, internal auditors should address risk consistent with the engagement's objectives and be alert to the existence of other significant risks.

2110.C2 - Internal auditors should incorporate knowledge of risks gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.

2120 - Control
The internal audit activity should assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.

2120.A1 - Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization's governance, operations, and information systems. This should include:

Reliability and integrity of financial and operational information.
Effectiveness and efficiency of operations.
Safeguarding of assets.
Compliance with laws, regulations, and contracts.
2120.A2 - Internal auditors should ascertain the extent to which operating and program goals and objectives have been established and conform to those of the organization.

2120.A3 - Internal auditors should review operations and programs to ascertain the extent to which results are consistent with established goals and objectives to determine whether operations and programs are being implemented or performed as intended.

2120.A4 - Adequate criteria are needed to evaluate controls. Internal auditors should ascertain the extent to which management has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors should use such criteria in their evaluation. If inadequate, internal auditors should work with management to develop appropriate evaluation criteria.

2120.C1 - During consulting engagements, internal auditors should address controls consistent with the engagement's objectives and be alert to the existence of any significant control weaknesses.

2120.C2 - Internal auditors should incorporate knowledge of controls gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.

2130 - Governance
The internal audit activity should assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

Promoting appropriate ethics and values within the organization.
Ensuring effective organizational performance management and accountability.
Effectively communicating risk and control information to appropriate areas of the organization.

(www.theiia.org April, 2008)

Under either the old set of roles or the new set of roles, the internal auditor had a wide-ranging set of objectives which, if accepted by the management or Board, would make internal audit responsible for much of the prudential advice to the organization both operational and financial. In particular, to ensure reliable information, it would involve the internal auditor in the development and management of the internal control system. Also, one aspect of the protection of assets, involves the management of risk. Thus the internal auditor in his role of a protector of assets ends up involved in the management of risk. Further, the economical use of resources, and the accomplishment of goals imply that the internal auditor should have a quality management role.

2.4 Internal Controls and Their Development

The role of internal controls is often confused with the role of internal audit and, in fact, the interpretation put on internal controls by management would seem to preserve this situation (Mathews 1993). Internal control was studied by the Committee of Sponsoring Organizations of the Treadway Commission in 1994. The report released by this Committee (the COSO report, 1994) defined internal control as:

> *"a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives on the following categories:*
>
> *Reliability of financial reporting*
>
> *Compliance with applicable laws*
>
> *Effectiveness and efficiency of operations"*

(COSO 1994, and http://www.coso.org/publications/executive_summary_integrated_framework.htm, 20/9/2006)

The Institute of internal auditors (IIA) holds that this is a proper role of internal audit (IIA Handbook, 1997).

The designing and monitoring of the internal controls of an organization is considered by most management personnel to be an important function (Mathews 1993). How important may be seen by the fact that in a recent survey of fraud detection in Australia, over 30% of frauds were revealed by internal control procedures (KPMG, 2001). As a further indicator of the importance of internal controls, the work of Romano and Ratnatunga (1994) may be considered. In 1993, Romano and Ratnatunga undertook a series of case studies that aimed to determine what differentiated high growth rate firms from medium and low growth rate firms. One finding of the study was that all high growth rate firms had effective internal control systems (Romano & Ratnatunga 1994). Again, Lancaster (1997) considered the existence of an effective internal control system to be one of the key steps in the successful management of an organization. The COSO report (1994) also emphasized the importance of proper internal controls to an organization. If these studies are accepted, then it is recognized that it is important that organizations have efficient and effective internal controls.

The COSO report (1994) accepted that an organization's internal controls included the attitudes and actions of the members of the organization. If the inclusion of attitudes is accepted as part of the internal control structure of an organization then an interesting situation arises. An attitude is a state of mind. This has cultural implications, as culture can also be considered to result in a state of mind.

2.4.1 The Importance of Operational Internal Controls

Operational internal controls are vitally important and the absence of these types of controls represents a significant weakness in the management of any organization that employs a significant number of people.

Operational internal controls are controls designed to prevent organizations suffering financial damage as a result of a member of the organization making an inappropriate operational decision. That these controls are absolutely vital to the business is easily demonstrated by the following case.

2.4.2 Absence of Operational Internal Controls

There are many examples that show that absence of operational internal controls may result in organizations suffering considerable financial loss. One example of the outcome of absence of proper operational controls is contained in the following series of events.

During the 1950's and 1960's, there was a revolution in world shipping, as specialist ships replaced general cargo ships. Two specialist ships that became very common were the container ship and the roll on roll off (RO-RO) vessel. Vessels following this pattern were designed to open either the bow or stern (or in some cases both), to allow vehicles to be driven on and off the vessel with the minimum of fuss.

In 1973 The Tasmanian Transport Commission obtained a virtually new RO-RO vessel of approximately 700 tonnes gross, which it named the Straitsman (Herd, 1999). Within 6 months the vessel was lying on its side on the bottom of the Yarra River, Melbourne (Herd, 1999). What happened indicates the importance of operational controls.

By 23rd March, 1974, the vessel's sailings were routine, and that morning it sailed through the still waters of the Yarra River towards its berth. There were many reports about what happened next but the following is based on Herd (1999). As they could see the end of their tour of duty approaching, everyone on board started to prepare the ship for docking, and an expeditious unloading of the cargo, which mainly consisted of 2,170 sheep, so that they could take a well earned break.

As the vessel was manoeuvered into its berth, the rear loading door was opened. This was a procedure that had been followed many times in the past six months. It appears likely that each time the procedure had been started a little further from the berth. The rear of the vessel had only about 30cm freeboard with the waterproof rear door open. In the past some water from the vessel's following wake had entered through the door way during docking but been rapidly cleared by the bilge pumps. This time enough water entered the vessel to overcome the bilge pumps. Efforts to close the rear door at the last moment failed. The vessel rolled over on its side and settled on the bottom in 7 fathoms of water It is estimated that it took less than 2 minutes for the vessel to sink.

The subsequent Board of Enquiry remarked on the unusual nature of the accident in that a fully seaworthy vessel had sunk in still conditions within sight of its berth (Herd, 1999 and http://www.acay.com.au/~strachan/ships.htm October, 2006).

The vessel was raised and returned to service, remaining on the Bass Strait service until 1992 when it was sold to New Zealand interests. In October 2006 it was still in service. In short, except for the unfortunate start to its career, the vessel has had a long and unremarkable life.

Using the approach outlined by Reason (1990), it can be suggested that there were several systemic failures that led to the sinking. Once at least one of these was dealt with, by the insertion of a suitable control, then the danger of a repeat performance would be limited. In this case, the Straitsman's accident, would have been avoided if suitable control such as the following had existed:

1. Securely moor ship
2. Officer in charge of Docking authorizes opening of rear loading door
3. Open Rear Loading Door

From the above it can be seen that this disaster was due to a complete absence of physical also known as operational controls.

The disaster was expensive for the owners, the Tasmanian Government, who, while insurance covered some aspects, found that the cost of the marine inquiry had to be met. Further the flow-on effect to the islanders who relied on this service was substantial. There was also the flow-on effect of increased insurance premiums, and other uninsurable financial losses. All because no physical operational control procedures existed to cover a routine activity. A sad but true point can be made here. With a new form of operation, or the bringing into service of any new equipment, there is a risk that unforeseen differences in the handling of such equipment may lead to inadvertent mishandling and a disaster. The Straitsman is an example of this type of phenomenon. It was the first small RO-RO ferry to be put into service by TT Lines. But the Straitsman is not alone. There are many other examples of the failure to put in place operational controls covering day to day operations, and of a resultant disaster, because not enough thought has been given to the potential for disaster surrounding the new equipment and the resultant need for controls.

2.4.3 Failure to Adhere to Internal Controls

In the same way as absence of operational internal controls will lead to disaster, failure to adhere to internal control procedures can lead to disaster, and these often include physical internal controls. This type of failure and its results as discussed later at 5.2.1, using NASA as an example. Part of the problem NASA faced was balancing the cost of controls against the effectiveness of controls. Cost effectiveness of control systems has traditionally been recognized in the auditing profession, although in earlier texts it was considered in terms of the need for controls to be "practical and efficient" (Irish, 1966 page 48) and is still mentioned within auditing texts including Arens et al. (2007). While these texts discuss the need for cost effectiveness, no method of calculation is given. I would suggest that the concept of cost effectiveness means the general rule that the ongoing cost of the control is equal to or less than the maximum expected loss from failure due to the decision not to implement the control multiplied by the probability of such a loss occurring. This appears to align with the interpretation of cost effectiveness given in the wikipedia (en.wikipedia.org/wiki/Cost-effectiveness, April, 2007).

As seen above, internal controls by their nature are not just financially orientated. Many of the controls are operational in nature. For example, Washington State University Administration instructions (November 2006) in defining operational controls systems says that:

"*through the establishment and maintenance of operational procedures and controls to ensure that ………….. policy, objectives and targets can be met. (The operational area) will consider the different Activities that contribute to significant ………. impacts when developing or modifying operational controls and procedures.*

Part of this evaluation process will be to ensure that the procedures or controls comply with defined "Operational Control Specifications". If a procedure is needed, then it must meet the following conditions:

- *The procedure is established and documented*
- *The procedure is maintained, reviewed and updated at least yearly*
- *Operating criteria are stipulated in the procedure*
- *The procedure is communicated with suppliers and contractors (were applicable)*
- *The procedure is in line with environmental requirements (which include the ………….. policy, objectives and targets).*"

(http://www.ehs.wsu.edu/esrp490/operationalcontrol.htm, November, 2006)

This draws attention to the fact that controls need to be contained within operational procedures, including such operational activities as manufacturing and production. Thus controls are not just restricted to financial matters, but cover the entire gamut of business activities.

Recently management accounting researchers have paid much attention to the effect of organizational culture on the controls of an organization (Langfield-Smith, 1995, Kloot, 1997). Langfield-Smith examined the relationship between an organization's culture and the efficiency of the organization's operations, including its internal controls (Langfield-Smith, 1995). The interplay between the internal audit function (with its culture) and the organization (with its culture) was not considered by Langfield-Smith. In considering the efficiency of an organization and its internal controls, Langfield-Smith considered the organization either as a whole or as a dichotomy between management and factory workers. Goddard (1997) considered the role of culture in influencing the approach of individuals within an organization to aspects of that organization's internal controls. Again, while emphasizing the importance of culture in the acceptance by the organization of different internal controls, Goddard did not examine the relationship between an organization and its internal audit.

There has been considerable research into organizational structure, and its influence on organizational behaviour (Langfield-Smith, 1995, Kloot, 1997). In this regard, it should be noted that organizations can be very rigid or quite loose and fluid in their internal structure, and how the members interrelate with one another. When considering the role of internal audit, it must be remembered that management sets this role and may divide the functions that are considered by the IIA to be internal audit functions across a range of positions within an organization.

Wallace (1991) differentiates between accounting controls and physical controls by using chapter headings that refer to accounting controls. Wallace (1991) also recognized the existence of operational internal controls by giving “an operational definition of internal controls” that includes “methods and procedures adopted within a business to ensure that goals and objectives are met”. Wallace (1991) goes on to say “a major Midwest construction firm cut its ..(losses) .. when it set up physical controls”.

Physical controls are therefore seen by Wallace as important components of the controls system. The oversight of physical controls by internal auditors therefore is a key way of reducing potential loss.

2.5 The current role of internal audit

As at June 2005, Australian Corporations Law does not require a corporation to have an internal auditor[1], and many organizations do not have, and have not in the past, had an internal auditor (Mathews et al, 1993). While the IIA has set a wide-ranging role for the internal audit, to a large extent the role of the internal auditor is set by the management of the organization (Gul et al 1996 p586). If current authors are considered to be a guide then the present role of the internal auditor does not appear to be clearly defined. Internal audit is considered by most writers to be primarily “employed by individual companies to audit for management” (Arens et al 1996 p 8) or “assist the management of an organization to discharge its responsibilities effectively" (Gul et al. 1996, Gill & Cosserat, 1996) or "to add value and improve an organisation's governance" (Jub et al 2008) .

On the other hand, the Institute of Internal Auditors (IIA) takes a broad and detailed view of the present role of the internal auditor. Expanding on the basic list of roles set out earlier they go on to state that the internal auditor should be responsible for:

Ensuring both financial and operating information is reliable.

(www.theiia.org)

In this there are two parts:

(1) Auditing the financial records of the organization to ensure that the records that are presented to management genuinely reflect the underlying transactions.

(2) Auditing the physical activities of the organization to ensure that the reporting of these activities is accurate.

And:

Ensuring corporate activity complies with-corporate policies, plans & procedures and laws and regulations (IIA handbook 1997 paraphrased)

[1] This is not necessarily the case in the public sector, where various acts establishing public organizations

Again both the financial and physical aspects of the organization's operation should be audited by the internal auditor to ensure that both desired corporate procedures and the legally enforceable rules are followed. Thus, for example, the audit of compliance with environmental requirements is considered to be necessary in order to make certain that management can protect the organization from the losses that would occur if such requirements were ignored. It, therefore, includes ensuring government safety regulations are followed.

Safeguarding of Assets (www.theiia.org)

This includes:

Preventing assets from being lost through misuse, or theft. This can include being part of the security system and/or ensuring security systems designed to protect from loss are functioning.

Economic and efficient use of resources

This means being directly involved in examination of the operations of the organization to ensure that they function most efficiently and achieve the maximum effectiveness.

Accomplishment of established objectives (Sic.)

This means the internal auditor must be involved in assisting the organization to achieve the objectives it has set itself.

(IIA handbook 1997 paraphrased)

To carry out these functions, the Institute of Internal Auditors considers that internal auditors should of necessity be involved in the design of all the corporate control systems, including risk assessment procedures used by the organization (IIA handbook 1997,

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require different levels of audit to that specified by the corporations law.

pp64-68, and www.theiia.org, 2008). This requires the brief of the internal audit to go far beyond a simple financial audit role and include providing guidance on the overall operational risk management procedures of the corporate entity.

In particular *"being directly involved in examination of the operations of the organization to ensure that they function most efficiently and achieve the maximum effectiveness."*(IIA Handbook, 1997) effectively states that an operational internal auditor is the internal auditor who audits the operations of the organization to ensure efficiency and effectiveness. The IIA currently summarizes these two aspects of organizational activity with the word "quality" (www.theiia.org, 2008).

In fact Abdolmohammadi et al. (2006) stated that the internal auditor needed to be competent in several activities, including:

(2) U2: Understanding adequacy of control strategies.

(3) U3: Improve risk management and control.

(4) U4: Provide ongoing assurance to organizations.

The activity surrounding "providing ongoing assurance" would by its nature involve auditing the controls generally and this would include both operational and financial controls.

Thus from the point of view of the profession of internal auditors, operational auditing of operational internal controls is a normal role of the internal auditor, and thus the profession would claim that any person involved in an operational internal audit role, no matter how specialized, would be an operational internal auditor, and thus a member of the internal auditing profession, even if not a member of the professional body.

This approach, at least in the overview, is supported in practice by major international accounting firms (Cangemi 1993, p 5, p 60, Warren et al 1981). Thus, both the role and responsibility of the internal auditor are going through a period of expansion.

This is supported by the results of the survey of the internal audit function in Australia undertaken in 1984 by Cooper & Craig, and up-dated in 1993 (Mathews et al 1993). Both surveys supplied useful data on the attitude of CEOs to internal audit, the perceived roles of the internal audit function and the actual role. These surveys examined how both the CEOs and internal audit leaders perceived the role of internal audit within the organization. The surveys reveal that CEOs regarded the main functions of internal audit to be appraisal of the internal control system and review of the efficient operation of the business. This has changed over time and in the ten years between the last of the surveys referred to above, risk mitigation has become a key role of the internal auditor (Leung et al. 2004). However, Leung et al. (2004) found that the five tasks upon which the internal audit spent the most time were:

> "*internal control evaluation*
>
> *management and operational audit*
>
> *systems assurance*
>
> *business strategic risk assessment*
>
> *internal consultancy"* (Leung et al. 2004, page 49)

Thus the functional activities of the internal audit are still largely concerned with internal controls, management audits, and operational audits. Accordingly operational audits remain a key activity of the internal audit function.

In a recent management text, Pearce & Robinson (2007) discuss the role of internal audit in some detail, and appear to take a similar approach to the IIA in defining the role of the internal auditor.

As well as expecting internal audit to provide answers about financial matters within the organization, Pearce & Robinson (2007) include as a function of internal audit the development of answers to a series of questions concerning production operations, including the following (extracted from Table 4.3, P119):

- *Do production – operations employees use appropriate operations planning and controlling tools and techniques?*
- *Does the operation utilize quality control procedures?*
- *Are these procedures effective?*
- *What is the organizational safety record?*
- *Have production operations goals been established, and are work activities aimed at achieving these goals?*
- *Does the production – operations process work smoothly and with little disruption?*

Whilst the answers to these questions will have a financial effect, these questions are operational in nature. Thus, Pearce & Robinson (2007) expect that the internal audit be intimately involved in the management of controls over operations.

2.6 The Potential Role of Internal Audit

There are several directions in which the role and authority of the internal auditor may continue to expand. For example, Gul et al. (1996) consider that

> *"…it can be expected that the importance and stature of the internal auditor will increase and in particular that the internal auditor's role in assisting the external independent (sic) auditor's contribution will take on more significance in the future."*

This view is similar to the Institute of Chartered Accountants in Scotland with their proposal that the internal audit be structured as the main audit function and the external audit role being one of confirming that the internal audit is sufficiently complete and independent, that it may be relied upon in the same manner as the current external audit (McInnes, 1993). If this were to happen, as well as its current role, the internal audit would assume responsibility for assuring that the accounts are fairly drawn. Such a move would bring the role of internal audit back to the position it is described as holding in the Union Bank of Australia before 1892 (ANZ archivist). However, while the importance of the internal auditor would be enhanced by a move such as this, the functions involved in such a role, that is, management of the internal control system, would be virtually unchanged from the current role.

A further area of expansion of the role of the internal auditor is the area of risk management (Cooper et al., 1996, www.theiia.org 2008). While McLoughlin (1995) discussed risk in terms of financial derivatives, risk management includes the management of both financial and physical risk. Failure to manage a physical or financial risk properly will result in a financial loss (Doyon 1996, Turner 1994). A physical risk is therefore capable of being expressed in financial terms and becoming a financial risk. In this regard, Beaver and Wolfson (1995) developed a model of risk in which the total financial risk for a financial services firm includes risks related to the firm's products. It is not a great step to extend that model to cover the activities of businesses generally and to accept that the physical risks of a business contribute substantially to the overall financial risk of a firm. Failure to have proper controls in place and functioning is seen by some as a key cause of business failure (Heller 1995). It is considered that control of a business includes control of the risks of that business, and the best way to ensure proper control is for management to understand what is involved in the risk (McLoughlin 1995). In this regard a proactive approach, where the persons over whom the controls will operate are involved in the design of the controls, appears to lead to better outcomes than imposed controls (Tongren 1995).

Management thus needs to control physical risk effectively to ensure that the influence of physical risk on financial risk is properly managed. It follows that the role of the internal auditor in the design and monitoring of internal controls involves the internal auditor in the control of physical risk. This is now happening in some organizations. For example, it is a desire to protect their corporation from resultant financial loss that has caused Bell Canada's internal auditors to move into the area of assessing risks that include physical risks (Doyon 1996). Bell Canada is not alone in this regard, as shortly before merging to form BHP Billiton, the Broken Hill Proprietary Company Ltd. (BHP) strengthened and expanded the role of its internal audit function to include monitoring the management of risk (BHP Internal Audit Department, 1997). Both these actions are responses to breakdowns in existing internal audit operations in the recent past, as well as breakdowns in the internal controls of the organizations. Further, in considering the nature of risk, it should be noted that the restaurant chain, Brinker International Inc., considers the physical risk that customers may be exposed to unhygienic food to be a commercial risk that falls within the ambit of the internal audit department (Barr 1996).

Cooper et al (2006) conclude that:

> *"The function of internal auditors has changed from a more financially-oriented role into one which has focused on internal controls and risk assessment through the last two decades. CEOs have generally perceived internal audit as having a financial function, while internal auditors had moved their emphasis into systems and risks."*

This is in line with the concept that internal audit is becoming deeply involved in operational audit activities, as much of the risk in business lies in operations.

Other organizations tend to have these roles that would otherwise be recognized as internal audit roles filled by persons with different titles. For example, within the aviation industry, certain senior management pilots are appointed to ensure that the rules which the airline imposes on pilots are followed. At the same time, these pilots are charged with ensuring that these line pilots have sufficient skill and procedural knowledge to fly safely.

These senior staff members are basically charged with conducting procedure and safety audits.

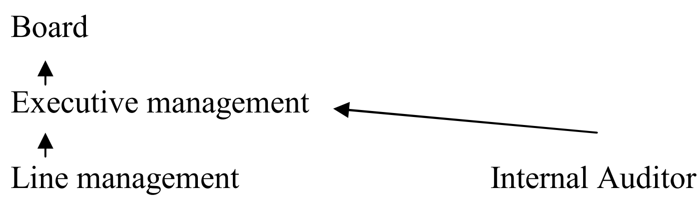
2.7 The Influence of Organizational Structure on the Internal Audit

As mentioned before at chapter 1 section 1.1, the internal auditor is a management appointment made within an organization and thus the level of responsibility of internal audit and the line of reporting both play a role in the internal audit function. In this regard, internal audit is normally a second tier role in the organizational management charts of most organizations. The reporting line can take one of three forms, which are shown diagrammatically in Figure 2.1.

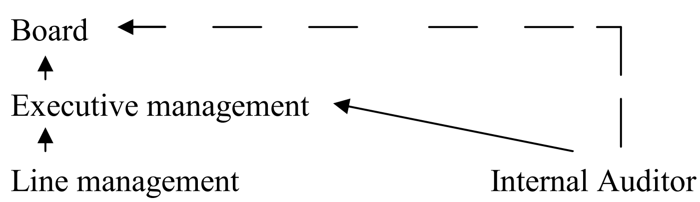
From Figure 2.1, it follows that the role of the internal auditor within an organization, actual in some organizations and potentially in others, goes beyond the design, implementation and monitoring of proper internal financial controls. It includes the design and monitoring of systems to limit the exposure of organizations to risks, including physical risks.

Figure 2.1 The Three Ways an Internal Auditor may Report Within an Organization

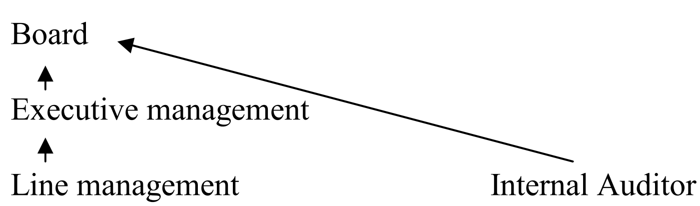
1 The approach that is common in many organizations surveyed by Mathews (Mathews et al. 1993):



2. Used by the ANZ Bank in the 1970s:



3. The approach that would seem to be required by Morleys case:



The efficiency of the internal audit in carrying out the functions and roles discussed above will be influenced by the degree of cooperation the internal auditor generally receives within the organization (Klinkerman 1996). Often the degree of cooperation is limited. In this regard the problems faced by internal auditors are considered to be a result of combining a fiduciary role and an advisory role thus creating the potential for a clash of cultures (Klinkerman 1996). It may be that the reporting elements of the fiduciary role identified in Klinkerman's analysis play a significant part in creating difficulties for the internal auditor, and taxing the auditor's diplomatic skills, because this role makes the internal auditor a form of spy entering into a particular area of the organization to report back on that area's performance. Thus he will be seen as an outsider to the group.

2.8 The culture of organizations

Schein (1985) defines organizational culture as

> *"a pattern of basic assumptions - invented, discovered, or developed by a given group as it learns to cope with its problems of external adaptation and internal integration - that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems".*

Schein (1985) developed a three-tiered model of the culture of an organization. The first tier is a set of basic assumptions relative to the environment, time and space, human nature and activity and human relationships. These assumptions generate a second tier; a set of values that were common throughout the organization, testable both in the physical environment, and through social consensus. These values set the third tier, being a pattern of behaviour, including behaviour that involves both interaction with technology, art and personal interaction.

In discussing how organizational culture comes into being, Schein (1985) identifies four stages in the establishment of an organization. The first stage is when the organization forms, that is, the coming together of the people involved in the organization and the selection and establishment of a leader. The second stage is the development of role differentiation within the group and the growth of peer relationships. In the third stage, the organization confronts the stability/creativity issue. Finally, in the fourth stage, the organization confronts the survival/growth issue. Schein (1985) recognized that while establishing themselves, organizations will go through catalytic marker events or critical incidents that will be internalized into the folk lore of the organization.

A similar model to Schein's is the model put forward by Rafaeli and Worline (2000) which suggests that an organization's culture will be recognized by the symbols it surrounds itself with.

Dent (1991) considers culture as having two interpretations, one as a metaphor, and the other as a variable. The concept of culture as a variable implies that culture is an endogenous variable that can be manipulated by management, along with other variables to achieve desired goals. The implication here is that management is untainted by culture, and stands independent. The metaphor view considers that management is both tainted by the culture of the organization, and is a manipulator of the culture. In this regard, organizational culture is simultaneously both an endogenous and exogenous variable.

Robbins and Barnwell (1994) defined organizational culture in terms of ten characteristics of the organization:

- attitude to individual initiative;
- risk taking;
- direction or objectives;
- integration within the organization;
- management support;
- control;
- identity;
- reward system;
- conflict tolerance;
- communications patterns.

They also discuss the existence of a set of core values that defines the culture of the organization, and the existence of subsidiary cultures within the organization.

Considering organizations as cultural entities, there are several models that can be used in analyzing an organization's culture. The models are not necessarily mutually exclusive. For example, one model considers the culture of an organization to be capable of conforming to four styles: role; power; achievement; and support (Pheysey 1993). The organization with a role style of culture responds to formal systems that give members particular roles within it and with which these members identify. The power style of culture emphasizes the particular powers of each member and drives the organization to look for strong decisive leadership. The achievement style of culture emphasizes the importance of "getting the job done". The support style of culture looks to the wellbeing of the members.

Another approach is that developed by Langfield-Smith (1995, p180). Following Ouchi (1981), Langfield-Smith divides organizational cultures into three different forms: market, bureaucracy and clan. In considering this model, it must be remembered that the nature of business culture is such that the forms of cultures exhibited by different firms are not identifiable by any sharp discontinuity but rather by Subjectively placed points on a continuum (Ouchi, 1981). Langfield-Smith used this model to demonstrate how organizational change may be managed in an organization. In Langfield-Smith's example, an organization which was very bureaucratic move towards becoming a clan based organization, and this allowed it to deal better with change because the clan was willing to endure individual sacrifice for the good of the whole organization. Thus Langfield-Smith held that an organization can adapt to changing circumstances by changing its culture. Bluedorn (2000) would hold that such a change requires careful management as it is likely to meet strong resistance.

Macintosh (1985 & 1994) also used a model derived from Ouchi, (1981). Ouchi (1981) considers that organizational culture has a significant influence on the nature and effectiveness of internal controls. Ouchi's view has remained valid over time; Langfield

Smith (1995) and Goddard (1997) hold the same view as Ouchi (1981). Macintosh (1985) considers the culture of an organization to be so pervasive in its effect on the organization's controls, that he uses the terms market controls, bureaucratic controls, and clan controls in describing the resultant control systems that exist under the different cultures. An outline of the definitions of these cultural models used by both Ouchi (1981) and Macintosh (1985 & 1994) and also by Langfield-Smith (1995) is set out in Chapter 3.

In considering the culture of organizations, and how culture may effect the form of the internal controls of the organization, it must be borne in mind that the culture of an organization is not rigid but changes over time (Langfield-Smith 1995). Further, large organizations are not necessarily homogenous, the different parts (divisions or subsidiaries) may have significantly different cultures (Cooke & Rousseau 1988). Larger corporate organizations with several divisions or subsidiaries may even have counter cultures operating within the same organization (Sackmann, 1992).

Further, the organizational culture is not necessarily reflected in the organizational structure. For example, Ouchi (1981) considered many Japanese organizations to have strong clan-based cultures rather than being either bureaucratic or market driven. This was because the members of the organization indicated that they strongly held a set of beliefs about the organization and its role in the world, which were instilled into them through a complex set of socializing ceremonies throughout their tenure with the organization. The organizations, however, exhibited highly developed relatively rigid command hierarchies that would normally be associated with bureaucracies.

2.9 Organizational Culture and the Internal Auditor

In those organizations that have an internal audit function, the internal auditor plays a key role in the design and management of the organization's system of internal controls which include controls over risk management (Mathews et al 1993). As organizational culture is considered to have such a pervasive effect on the internal controls, it follows from this that the internal auditor must consider the nature of the organization's culture when designing and monitoring the internal control system for the organization.

It is worthwhile noting that the Committee of Sponsoring Organizations of the Treadway Committee (COSO) hold that "management's philosophy and operating style" is a significant influence on the internal control system of an organization (www.coso.org 2008). The COSO view is reflected in the position taken by the IIA (www.theiia 2008), who are one of the sponsoring organizations of COSO (www.coso.org 2008). The term "management philosophy and operating style" would appear to be a synonym for culture, at least at the management level. Others would hold that the culture of the organization as a whole is a driving force in deciding how well the organization's internal controls function. In fact, the European School of Management has recently established a Chair to study three aspects of management, one of which is "culture and internal control" (www.escp.eap.eu 2008).

2.10 The Internal Auditor and the Organization – Anecdotal Comments and Other Problems

In preparing for this study, a small number of internal auditors was interviewed, and their views on the attitudes of middle management to internal auditors were noted. These findings coincided with the experience of the writer when he was involved in internal audit of a major trading bank some years previously. From these interviews with internal auditors employed in several different companies and later interviews with a number of middle management personnel, it was noted that there is a wealth of anecdotal evidence concerning the internal auditor's relationship with others within an organization. One example is the comment made by a member of middle management of a major international bank: "Internal auditors need something to put in their report in order to justify their existence, thus they will nit-pick if they have no major problems to report." (interview: Banking Management Subject 2, 2002). Thus, a history of anecdotal evidence of "getting on the wrong side of the person being audited" has been created (Banking Management Subject 2, 2002). In fact if these interviews are collated, the outcome is that with reasonable certainty the auditor is seen by most management as having a more rigid attitude to the method by which organizational goals are to be achieved, a different attitude. While not directly admitting to the existence of such a problem, the Institute of Internal Auditors has created a standard "260 Human Relations and Communications – *internal auditors should be skilled in dealing with people and communicating effectively."*(IIA Handbook, 1997). The Institute of Internal Auditors has published at least one article in Internal Auditor, pertaining to this problem of perceived attitudes and views. The title of which indicates the nature of the problem: “Oh no the (internal) auditor is here” (Chadwick, 2002).

There is other supporting evidence that the position of internal auditor is one that may see the organisation in a different way to the middle management of the organisation. For example Van Peursem and Pumphrey (2005) while principally looking at the internal auditor from the point of view of agency theory, and also considering the problems faced by the internal auditor when clear lines of responsibility for the internal audit are not outlined, did however mention the difficulties an auditor faced from within an organization. In their view the difficulties arose because of the different expectations of the internal auditor from the different levels of management within the organization.

.It needs to be kept in mind however that the internal auditor is different to the external auditor, in that the internal auditor is generally considered to be a member of the organization he is auditing. Thus he faces the organization as an insider rather than an outsider.

A key difficulty faced by the internal auditor is that his or her appointment is generally relatively short-term. The individual is cycled through the position to gain experience “on the job” before moving on. (Mathews et al 1993). It takes time for an organization to assimilate a new member into the culture of the organization (Coffey et al 1994). Given the generally relatively short-term appointment of the internal auditor, the organization may have too short a time to assimilate a new internal auditor into its culture, and the internal auditor's role within the organization will not properly fit within the culture of the organization. Thus, the internal auditor will feel "the odd one out" within the organization. As the respondent to a survey of attitudes to the use of the internal auditor as an adviser within an organization put it "management tolerates internal auditors but does not want them operationally involved" (Glover & Romney 1997). This implies a significant difference between the culture of the organization and the culture of the internal auditor. Even if the new internal auditor is given time to assimilate as an internal auditor, he will still find this difficulty in some organizations. The senior internal audit role, however, is often filled by a long-term auditor. Leung et al. (2004) found that of 85 chief audit officers that responded to a survey, 45 had held the position for in excess of ten years. This is to be expected, the cultural problems faced by the ordinary internal auditor, who will have held his position for a much shorter period of time remain, however. This is supported by a study discussed by Goodwin and Yeo (2001) which found that the use of internal audit as a management training ground was widespread. If this is the case then future managers would be unlikely to be left as an auditor for long.

There is also a potential for culture in the broader national and international sense to impinge on cultural attitudes, including the attitude towards internal audit. For example, Kachelmeier and Shehata (1997 p429) considered that in societies where trust[2] was considered an important component in the achievement of organizational goals, the imposition of a form of audit, even on a voluntary basis, may be counter-productive.

The restructuring of organizations, which has been widespread in the 1980s and 1990s (Otley 1994), often leads to a greater number of empowered employees (Leifer & Mills 1996), with high levels of delegated authority, as organizations move to operating more technologically flexible systems (Leifer & Mills 1996). The use of imposed internal controls in an organization that is no longer based on a bureaucratic culture, but rather is now a clan-based culture, may cause members of the organization to consider the controls unnecessary and ignore them. As mentioned previously, the internal auditing profession is promoting the concept of "Control Self-Assessment" or CSA. Part of the reason for this development is to overcome this difficulty (Fritsch 1996).

CSA involves the auditee in the development of both the control programs to be faced and the audit program (Baker & Graham 1996). The purpose is to motivate the employee to follow the set controls, as the employee has been involved in the design of the controls (Baker & Graham 1996). Despite the support that CSA is gaining in the literature (www.theiia.org 2005), this is considered an improper approach to the development of internal control systems by some researchers in the area of internal control (Brownell 1995). It is possible that organizational culture will impact on the efficacy of CSA. The form of the control system is accepted as one of the ten characteristics of organizational culture (Robbins & Barnwell 1994). From this it follows that attitudes to controls are dependent on culture. The result is that where the culture of the organization does not support a high level of self-control, given the high level of freedom that exists following

[2] Hofstede 1993 uses attitudes to trust as one of the defining attributes of national culture.

organizational restructures where middle management is reduced, and authority delegated down the line, CSA may fail.

For reasons similar to those relating to the problems with CSA, the use of “self-directed audit teams” of internal auditors is also being developed. Here the purpose is both to improve the attitude of the internal auditor in terms of job satisfaction, and to assist the internal auditor to make better decisions (Baker and Graham 1996). This need that Baker and Graham (1996) have identified to improve the attitude of the internal auditors leads to the concept that there is likely to be a difference in culture between the organization and its internal auditors. It is therefore likely that the performance of the organization’s internal auditors will depend on both the culture of the organization and the sub-culture of the internal audit group.

The question which arises is whether the cultural and control environment of the organization is considered likely to influence the ability of the modern internal audit function to carry out its role. The influence over the control environment that the internal audit function possesses may be determined more by culture than by formal structure. This is a particular problem given that the empowerment of employees (delegation of authority) may have been implemented more as a “fad” than a developed strategy, and the resultant effects on business control may not have been properly examined (Sweeting 1995). For example, members of bureaucratic organizations which are rule based and follow structural lines of authority may be accepting of internal audit processes. In contrast, clan based organizations which regard rules as guides to assist members, may be less accepting of internal audit. However, they may be more likely to accept CSA as this allows for participation rather than blindly following rules.

2.11 Forms of Internal Audit

Since at least the 1950s the professional organization the IIA have recognized two main forms of internal audit, the financial audit and the operational audit.

2.11.1 The Financial Audit

A common form of internal audit is the financial audit. This audit involves the investigation of the accuracy and verifiability of the accounting data generated by an organization (IIA Handbook, 1997). This aspect of internal audit, includes the verification of financial data was recognized by the IIA from virtually the time of the formation of the IIA in 1941 as a key function of internal audit (Thurston, 1950).

2.11.2 The Operational Audit

The financial audit is not however the only role of internal audit. In fact as early as 1950, Thurston (1950) considered that internal audit included both a financial aspect and "*calling attention (the) inadequacy of physical property and the lack of propriety in its use.*." This is not a financial audit but rather an approach to the start of operational auditing. Other roles include monitoring of internal controls (Thurston, 1950, Arens et al., 2007). By the middle of the 1960s, as well as financial audits, operational audits of various types were seen by the internal auditors as an important aspect of internal auditing worthy of its own set of instructions (Kowalizyk, 1984). In fact, in 1964, Bradford

Cadmus, one of the leading members of the IIA (Kowalizyk, 1984) wrote monograph entitled "operational internal audit handbook".

Further developments in the role of audit in the operational area have meant the creation of quality audits (www.asq.org, March, 2007), performance audits (Arens et al., 2007) and compliance audits (Anthony 1968, Arens et al., 2007). Thus internal auditors are involved in a wide range of activities. In fact, in 2003, Leung found that, of 85 internal auditors across various sectors, 87% were involved in design and/or monitoring internal controls while 67% were involved in risk management and 68% in compliance audits of various types. 39% were involved in direct operational audits (Leung, 2003).

In 1967, E.B. Meyers, the Chief Internal Auditor of Canadian National Railways considered that operational auditing included auditing "*..all phases of the operation…*" of the organization (Meyers, 1967). This gives the operational internal auditor an extremely wide role.

Having this wide role however did not come without a price. Seiler (1966) mentions the possibility of difficulties in the relationship between operational management and operational auditors. In fact J.R. Allen, the Director of Audit Services for American Radiator and Standard Sanitary Corporation, being diplomatic in his approach to this problem says:

"*the importance of proper perspective and tone in report presentation cannot be over-emphasized too strongly. In large measure, this determines the success or failure of an operational audit program regardless of the manner in which the audit is conducted"* (Allen, 1967).

The implication of this statement is that the operational internal auditor will bring to the audit a different set of values to the personnel being subjected to the operational internal audit. While this would not have been seen as a cultural issue in 1967, within a few years organizational values held by individuals within an organization would be interpreted as a key indicator of their culture, see for example Hofstede (1980) whose work will be discussed in chapter 3. Further the need to be diplomatic suggests that there existed tensions between the organization and its operational internal auditors.

2.12 Summary of the Perceived Role of the Internal Auditor

There is a general view held both by the CEOs and the internal auditors of those organizations with an internal audit operation that the internal audit function has a broad responsibility to ensure that an organization's internal controls function properly. This responsibility covers the controls designed to manage and provide information on all aspects of the business from the controls over the basic activities of the business and the level of risk in these business undertakings through to controls designed to ensure the basic accuracy of financial reports.

The role of internal audit is expanding and will continue to do so following the passage of the Sarbanes Oxley Act (2002) in the USA and the flow-on effects this is having. The Sarbanes Oxley Act requires management to make certain that they have effective internal controls. Up until the passage of this Act, there was no formal legislative requirement in the USA for the institution of internal controls within corporations. The

Act changed this. The Act impinges on activities outside the USA to the extent that companies seeking to be compliant with USA law for the purpose of raising funds through USA listing must comply. The result has been a surge in interest in both internal controls and the best way to achieve compliance with the Act. One recognized way of providing the monitoring of internal controls that is necessary under the Act is to have an effective internal audit.

CHAPTER 3

THE KEY MODELS OF CULTURE

While corporate or organizational culture has been studied for some time, it was not until relatively recently that the nature of the culture of an organization was considered to be an important indicator of the success of the organization with such studies as:

Hofstede's multi-dimensional model;

Ouchi and Macintosh's three dimensional model;

Cooke and Lafferty's Organizational Culture Inventory; and

Cameron and Quinn's competing values framework.

3.1. Hofstede

Early in the 20th century some remarkable men created organizations that epitomised the industry in which the organization functioned. These organizations were considered to have a unique culture that was moulded by the creator of the organisation. An example of this is IBM. Originally founded as the Computing Tabulating Recording Company (CTR) and run by Herman Hollerith, as the organization grew, it changed its name to IBM and a long standing employee; Thomas J. Watson, Sr. was chosen as General Manager, Watson created a strong "extended family" culture within the organization. Writers consider this to be part of the cause of the success of IBM (http://www1.ibm.com/ibm/history/history.html, 2004). By the 1960's IBM had expanded its operations such that it had offices in many countries. This made it a suitable target for a study of the effect of country cultures on the management of such an organization. This availability of a Subject organization coincided with the needs of researchers such as Geert Hofstede.

3.1.1. The Recognition of Country Cultural Differences, Hofstede (1980)

Research in the area of culture within organizations has resulted in a number of theories. By the 1970s two major studies had been undertaken. One was the work of Hofstede, G., which he summarised in the book "Cultures Consequences" (Hofstede 1980). The other was a work on the concept of culture titled "Theory Z" by W. G. Ouchi, which considered the apparent economic success of Japan in the 1960s, and suggested that the principal reason for the apparent success was cultural (Ouchi, 1981)

Hofstede studied the differences in culture within one organization, across national boundaries (Hofstede 1981). In this study he was looking at how the organization had problems managing its various subsidiaries in different countries. To do this Hofstede studied the differences in attitude of employees at branches located in different countries. During the study he identified four dimensions by which he considered the differences in culture could be highlighted and measured.

3.1.2 Hofstede's Multi Dimensional cultural model

Hofstede (1991) discussed his original findings from work published in 1981 and subsequent developments.

In his early study, Hofstede studied the different cultures that existed in the offices in different countries of one multinational. His findings enabled him to develop a model of culture based on the following dimesions:

Power distance;

Masculinity/femininity;

Uncertainty avoidance; and

Individualism/collectivism.

3.1.3 Power Distance

This concept involved the idea that different societies accept different levels of inequality. The measure resulted from asking employees to rank three different personal attitudes to management; their level of fear of disagreement with management, the extent to which the decision making style of management is autocratic, and the preference for autocratic or consultative decision making styles.

The results of this survey indicated that different countries accepted employees following different levels of participation in management. The survey looked at the way persons in different countries resolved differences in power as between individuals within that country.

3.1.4 Masculinity/Femininity

Again Hofstede's results here are from his survey of persons in different countries employed by the same multinational. Here the measure was of the extent to which confrontation was an acceptable form of dispute management, rather than conciliation. He could have called this measure “confrontation/negotiation but chose to call it “masculinity/femininity”. The view taken by Hofstede was that while the tendency towards confrontation was a masculine trait, conciliation was considered to be a feminine trait. He justified this approach, on a country scale, by examining the social rights of men and women within the countries he was studying. He found that in those countries where dispute management was confrontational males generally had significantly more rights than females, while in those countries with a conciliational dispute management style the rights of men and women were more evenly balanced. This finding underlies the reason he chose to call the dimension masculine/feminine, and not confrontation/negotiation.

3.1.5 Uncertainty Avoidance

Hofstede (1991) noted that people from certain countries were more likely to avoid uncertainty than others. People from some countries seemed to revel in there being no certain way of dealing with a problem, while others sought to place a structure about all things. He noted that in countries where the population tended to be less interested in uncertainty avoidance there seemed to be a “horror of formal rules”.

3.1.6 Individualism/Collectivism

Hofstede (1991) recorded that the attitude of workers in different countries to the relative importance of the personal as against the group goals. This he considered a separate dimension of culture that differed across the different countries tested.

3.1.7 The Use of the Model

Hofstede tested this four dimensional model as a predictor of behaviour within different countries. He validated the model by comparison with the behavioural findings of others who studied cultural and behavioural differences between different countries. For example, Hofstede chose to use Laurent's study of the conflict resolution approach taken by managers from different countries (Hofstede 1991). Laurent (1983) had recognized that manangers from a strongly masculine background showed different decision making and behavioural traits to those who came from a more feminine background. Hofstede used Laurent's findings to validate the decision to use masculinity/femininity as a dimension of culture (Hofstede 1991). Laurent's model correlated to Hofstede's model in that it contained the following methods of discriminating organizational culture, which correlated closely with Hofstede's discriminators:

Organizations as Political Systems – Hofstede's Masculinity/Femininity;

Organizations as Authority Systems – Hofstede's Power Distance;

Organizations as Role Formalization Systems – Hofstede's Uncertainty Avoidance;

Organizations as Hierarchical –Relationship Systems – Hofstede's Individualism-collectivism.

It should be noted that Laurent refers to several works of Hofstede's including *Cultures Consequences: International Differences in Work-related Values* (Hofstede, 1980). That had been instrumental in the development of his theory.

Hofstede (1991) identifies how the cultural differences between countries where a multinational operates generates operational difficulties if those cultural differences are not properly managed. Thus, the general use of the model is in recognizing different cultures in different countries and allowing managers to plan for these differences in the operations of multinational companies. This means the model is geared towards recognizing differences in the culture of countries, rather than cultural differences within an organization that are not caused by different country cultures.

3.1.8 Hofstede on Corporate Culture

Hofstede (1991) recognized the difficulties of his four dimensional model in handling corporate culture, and drew a corporate culture model based on the nature of the organization. In this he used the work of Ouchi (1980). He recognized Ouchi's bureaucracy as a highly structured form of organization. A less structured one he describes as "family" in nature is considered by him to match the Ouchi clan organization. Hofstede also recognized the work of Williamson in developing a model based on hierarchy v market dimensions (Hofstede 1991). When this is combined with the Ouchi (1980) model, it gives a three dimensional model consisting of the "bureaucracy/hierarchy structure, the clan structure, and the market driven structure. Hofstede (1991) did not totally recognize the structure given by Ouchi (1980), as he developed a four dimension model with a fifth dimension overlaid over the other four. Thus he had dimensions of:

Professional bureaucracy

Full bureaucracy

Adhocracy

Simple structure

The fifth dimension that overlaid the others was standardized divisional organizational form.

He took the view that these structures would be found in particular countries as best reflecting the organizations that matched the country's culture in terms of his four dimensional country culture model.

As a more appropriate method of evaluating organizational culture, Hofstede (1991) proposed that a six dimensional model be used, the dimensions being:

1. Process orientation v Goal orientation
2. People (employee) orientation v Job orientation
3. Organizational identity (parochial) v Professional identity
4. Open system v Closed system
5. Tight control v Loose control
6. Pragmatic v Normative

These terms describe the mechanics of a cultural model that may be described in other summary terms, with similar meanings.

Hofstede (1991) was looking at attitudes within one corporate entity, thus it may be considered that the entity's own culture may play a role in defining the limits of power distance beyond that of the country's culture. In that regard the example of power distance within different military organizations may be taken as an example to hold up against the ranking that Hofstede (1991) developed. The ranking table ranked Australia at 36 and the USA at 40 as very close. One would assume from this that only minor adjustment would be required to move from one culture to the other. Yet I have interviewed several USN and RAN personnel about the cultural attitudes to power distance in the RAN and the USN. Although the direction is as predicted, the difference appears substantially greater than the difference in ranking found in Hofstede's (1991) table would predict. For example, a captain of one USN vessel visiting a RAN vessel spent some considerable time trying to find the captain of the RAN vessel, only to discover that the person who first greeted him as he stepped on board was in fact the captain. He left horrified with the "familiarity" of the crew. His ship's clerk who had accompanied him was impressed, not with the familiarity, but with both the thoroughness of the crew's training and the ability of the crew to work as an integrated team, with things happening without obvious command. He felt he "had stepped off John Paul Jones' ship into the 21st century." (interview Subject 2, 2002)

3.1.9 Uncertainty Avoidance

This dimension is based on the level of desire for certainty in different cultures. Uncertainty about the future is a fact of life (Hofstede 1980). There are several ways of appearing to minimize this level of uncertainty.

Some societies will develop rituals that appear to the group as a means of providing group cohesion and thus some level of certainty. The group sees the ritual as a way of recognising the existence of some device that will give certainty to the future. Thus in early society ritual sacrifices to protect the harvests were undertaken (Hofstede, 1980). The fact that intelligent application of knowledge of cause and effect might lead some members to be able to appear to predict the future, and take advantage of this did not concern an uncertainty avoiding society as a whole. At times in history when uncertainty was everywhere, the society that existed in those situations inevitably looked for certainty. The strong desire for certainty often was sufficient to accept on faith that which was received doctrine. Thus, for example, the Egyptian priests maintained their powers by accurately predicting the future flooding of the Nile River. The non-priest classes accepted the priests as having magical powers to predict the future, not as people with a nileometer, and a good network of spies in the hills to advise of the arrival of rain and melting of snow.

One way that societies seek to create an acceptable level of certainty in social interaction is to construct behavioural rules. The implication is that the more strongly the members of a cultural group wish to avoid uncertainty the more they create rules. Further, the more strongly a cultural group wishes to avoid uncertainty, the more rigidly the cultural group's rules are interpreted. Thus the statement "rules are made for the obedience of fools and the guidance of wise men" (Bader, 1954) is considered anathema to a strongly uncertainty avoiding cultural group.

Thus, high uncertainty avoiding societies will look upon rules and rituals as sacrosanct. Admittedly this is outside the realm of the corporate organization, but Hofstede (1980) identifies a number of high uncertainty avoidance societies, and then discusses the imposition of highway speed limits in these societies as compared to the imposition of speed limits in low uncertainty avoidance societies. Hofstede notes that high uncertainty avoidance societies have tended not to impose highway speed limits while low uncertainty avoidance societies have. Hofstede (1980) suggests that this is because higher uncertainty avoidance societies value time more than lives. There are other interpretations to this. I would suggest that, given that the governments of all the societies considered in his study are elected, the high uncertainty avoidance societies rulers choose to avoid uncertainty in their careers that may follow if they create unpopular laws. They therefore do not create such laws. They also consider laws that cannot be strictly enforced bad laws. The social expectation in high uncertainty avoidance societies is that all laws can be followed with precision. Low uncertainty avoidance societies tend to the law/guidance view stated before, and accordingly do not attach the same social stigma to breaking the law.

3.1.10 Individualism

Hofstede (1980) sees Individualism as the opposite to collectivism in society. From an organizational perspective it is the level of emotional dependence on the organization and the extent to which the organization supports the individual. If the support is high, or the emotional dependence is high, then the organization is considered to be taking a collective rather than an individualist approach. It is suggested that the degree of modernity of the society also drives the level of individualism. Here, Hofstede quotes Triandis (1971) “Modern man.. .. is open to new experiences..” while “Traditional man

…. Receives direction…" . Hofstede surmises from this that modernity and individualism are linked, and that more traditional societies will tend to be more collective.
Hofstede considered that high values on personal time, freedom, challenge, and use of personal skills indicated a high level of individualism.

3.1.11 Masculinity

Femininity/masculinity is considered by Hofstede (1980) to show how different countries value the goals of men and women differently. For example men consider advancement, responsibility and being a supervisor, high pay, working on core problems, and creativeness important goals and attributes. According to Hofstede (1980) women consider a congenial working atmosphere, leisure time, good relationship with superiors, variety and good physical working conditions most important.

Hofstede (1980) developed a questionnaire that enabled him to measure where business operations within different countries ranked relative to the above four dimensions.

3.2. Ouchi (1981) and Macintosh (1985)

Ouchi on the other hand was writing about Japan and comparing the Japanese to the Americans. His measures of the cultural differences were based on the concept of a three dimensional model of culture. The model in its simplest form classified an organization according to which of the three culturally important dimensions predominated in a particular organization. The three different forms of organization recognized by Ouchi were bureaucracy, clan, and market (Ouchi, 1981). Ouchi's model was refined by

Macintosh, but the essential ingredients of three types of culture, bureaucracy, market, clan remained (Macintosh, 1985).

3.2.1 Bureaucracy

The bureaucracy is characterized by a formal chain of command or hierarchy, and structured written procedures that must be followed. Ad hoc actions are discouraged, and may be heavily penalized. The bureaucracy is highly structured and relatively inflexible. As a result, this form of organization may find it difficult to change rapidly and adapt if its environment alters in any way. Thus rigidities prevent rapid innovation. This is not to say that bureaucracy does not have its place. Where the accurate performance of standard routine procedures is required, this form of organizational structure will serve very efficiently (Macintosh 1985).

3.2.2 Market

The market-driven organization recognizes the primacy of the market. Thus it spends much time monitoring its market, and more time adapting to any perceived changes in this market. From this perspective it may be considered a reactive adaptive organizational structure. In a pure market-driven organization, all components of the organization will have a strong desire to meet the market, and beat the competition. It is here where the danger to such an organization lies. For the perception of what the market wants in the long-term and short-term may be both incompatible with reality and internally incompatible (Macintosh, 1985).

3.2.3 Clan

The clan structure is viewed as being both collegial and flexible. The clan sets out as a team to achieve the desired result. This team will adapt and incorporate changes in order to better achieve the result. The team will tend to have a belief in itself as a team. All members of the team will be considered valuable contributors to the team. As a result the clan will often go beyond collegiality, and approach the position of being an extended family.

3.2.4 Difference between Macintosh and Ouchi

Macintosh took a micro approach. While Ouchi applied the model to a group of countries, Macintosh applied the model to individual organizations. This step meant that Macintosh recognized that organizations have distinct cultures (Macintosh, 1985) while Ouchi did not consider that point to any extent but restricted his considerations to differences in country culture (Ouchi, 1981).

3.3 The Organizational Culture Inventory

This approach to the recognition of organizational culture was developed by Cooke and Lafferty (1987) and expanded upon by Cooke and Szumal (2000).

The approach is similar to Cameron and Quinn (1999) discussed next, in that it considers a series of behavioural expectations or norms and divides the culture according to which norms are the most important into three cultures, a constructive culture, a passive defensive culture and an aggressive defensive culture. The difficulty in using this approach to measure sub-cultures within an organization is that it considers organizations to be either aggressive or defensive in nature, which places limits on the concept that a sub-culture may be wishing to advance the organizations goals while still having a culture and, therefore, a perspective or vision of the organization that is not the same as the organization's own vision of itself.

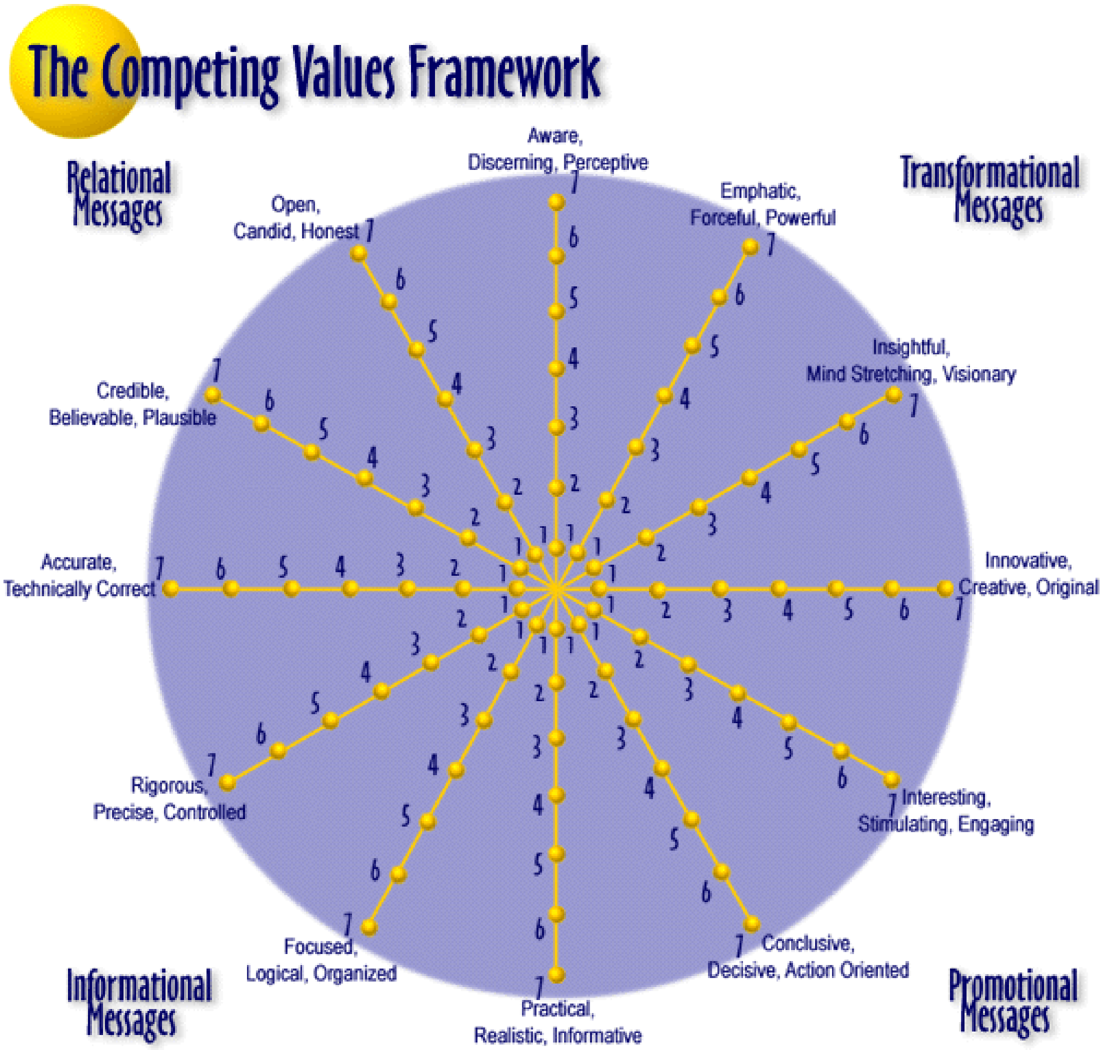
3.4 The Competing Values Framework

This is a framework put forward by several authors, but notably Cameron and Quinn (Cameron & Quinn, 1999).

The concept developed initially as a way of considering the way companies communicated internally. The basic position being that an organization's management would see certain values as important to the organization, and in communications those values would be emphasized. The degree of emphasis of particular values would to some extent also be guided by the purpose of the communication. Thus an operational instruction would emphasize such points as technical correctness; rigorous, precise and disciplined processes; being focused and logical; and practical informative realistic and instructive. On the other hand an address to employees would seek to be innovative; insightful; interesting and stimulating (Quinn et al., 1991). Such a model is set out in Figure 3.1: Figure 3.1 is extracted from http://webuser.bus.umich.edu/Programs/BMC/CompetingValues.htm (2005) (University of Michigan Business Management Course) The diagram was, however, designed using Quinn et al. (1991) as its source. It should be noted that this diagram used a 7 point scale along each spoke (or ray) of the model. The scale was a modified likert scale which ranked each spoke in terms of the strength with which the aims of each spoke were achieved by the particular communication. The spokes (or rays) each represented certain key aims that are found in communications.

The original purpose was to study the concepts behind communication within an organization, however it was realized by Cameron and Quinn (1999) that the same approach could be used to facilitate the study of organizational culture.

Figure 3.1



One advantage of the competing values framework is that it recognizes that an organization's behaviour will not be totally driven by a single aimed position, in that it may weight as important particular sets of aims that on initial examination would seem contradictory. The probability that the level of weighting of contradictory aims will be identical is, however, considered to be remote. To explain by example; a clannish organization would not totally ignore the market it is serving, otherwise it would rapidly cease to exist. It would therefore express some interest in serving its customers (or orientation towards its market), while at the same time remaining clan-orientated. Thus if it was asked to allocate values to its clan orientation and values to its market orientation, it would allocate some value to both orientations, simply (because it is a clan) a higher value to its clan orientation than its market orientation. The problem with the Ouchi/MacIntosh model set out above is that the model declares an organization to be a clan or a market driven entity, not a mix of competing ideals (MacIntosh, 1985, Ouchi, 1981). Cameron and Quinn (1999) recognizes that the existence of this competition between values, will not always lead to an outright winning value. Shades of grey do exist.

The resultant plot of the weightings (1 to 7) given to each of the different values will be generally consistently interpreted by the members of any particular organization. This gave a way of analyzing the intentions of the communications of the organization in terms of the particular aims that may be linked with a particular aspect of the culture of the organization.

Cameron and Quinn (1999) recognized the fact that this method of analysis could go beyond considering just the nature of communication within an organization, and could be used to study the nature of the culture of an organization. Just as communications may appear to contain elements that are in internal conflict with one another, so organizations cannot be considered as culturally perfect.

Cameron and Quinn's (1999) study started with a recognition that, while the existing model of cultural absolutes was useful to describe management communications processes, it did not directly translate to a cultural model that recognized the complexities of culture. Like all models it was a simplification of reality. Quinn et al. (1991) considered the model was too simple. For one thing, Quinn et al. (1991) considered that within an organization, the management would use communications that emphasized different aspects of the cultural model to achieve different aims. Thus there would be an element of competition between the different cultural attributes of the organization. These attributes could be considered as values. The question that Cameron and Quinn (1999) set out to answer was; what would be the types of values the spokes (or rays) of a competing value of culture model be labeled as representing.

The outcome of their studies was that they found what they considered as four primary identifiers of the culture of an organization. Paraphrasing Cameron and Quinn (1999), these are:

1. The extent to which an organization's members were able to make ad-hoc decisions in response to problems as they arose. This could almost be summarized as decisions on the run. They called this ray adhocracy.
2. The opposite to that was considered to be the extent to which the organization was bound by rules or was a hierarchical or a bureaucratic structure. They called this opposing ray hierarchy.
3. The extent to which the organization behaved as an extended family towards its members. This ray was called clan.

4. The extent to which the market or desire to achieve in the market was a driving motivation of the organization. This ray was known as market.

(Cameron & Quinn, 1999).

Thus to Cameron and Quinn, the culture of an organization could be measured by the extent to which the members considered each ray important. In the earlier model, Quinn et al. (1991) used a 7 point Likert scale. In the later model Cameron and Quinn (1999) used an allocation of 100 points across each of four options in six questions. Subjects were supposed to allocate the points on the basis of their perception of the weighting of each of the four answers to each of the six questions. Thus they allocated 600 points in all.

3.5 Macintosh and Ouchi compared with Cameron and Quinn

Cameron and Quinn (1999) developed a model of the culture of an organization with one further dimension in comparison to the Macintosh/Ouchi model discussed earlier.

A direct comparison is set out in figure 3.2:

Figure 3.2 : Macintosh/Ouchi v Quinn/Cameron

Macintosh/Ouchi	**Quinn/Cameron**
Clan	Clan & Adhocracy
Bureaucracy	Hierarchy
Market	Market

The attributes are given by Cameron and Quinn (1999) as follows;

Clan:

A friendly place to work, being an extended family with mentoring leaders, high commitment, importance of the workers, premium on teams. Success is measured in terms of customer satisfaction. The organization is held together by loyalty and tradition

Adhocracy:

Dynamic, entrepreneurial, risk taking, innovative, the emphasis is to be on the leading edge, long term aim is growth. Leaders are innovators. Success is measured in terms of being the first out with the latest most unique product. The organization is held together by the commitment to experimentation and discovery.

The Hierarchy:

A very formal and structured organization. Rules and Precedents are important and are a key to holding the organization together. The leaders are co-ordinators and organisers. A smooth running organization is the aim. Success is defined in terms of dependability.

Market:

Competitively orientated, the organization is held together by the desire to win. This implies a management that is very goal oriented. The organization is focused on achieving goals and targets in the market. Success is defined in terms of market share.

3.5.1 Macintosh's Definition of a Bureaucracy compared with Cameron and Quinn's Hierarchy

Macintosh view of a bureaucracy is an organization with a formal chain of command and structured written procedures (Macintosh 1985). Cameron and Quinn (1999) view a hierarchy as a formal organization with rules. When looked at behind the slight differences in language, very little separates Macintosh's bureaucracy and Cameron and Quinn's hierarchy. The terms are interchangeable given the similarity of definitions.

3.5.2 Macintosh's Clan and Cameron and Quinn's Clan and Adhocracy

Macintosh (1985) states that clans are held together by group loyalty and tradition, and have a willingness to adapt, albeit in a traditional fashion, to achieve a goal. Thus a Macintosh clan has an ability to adapt (the Cameron and Quinn (1999) adhocracy) and a group and traditional element (the Cameron and Quinn (1999) clan). The position that Macintosh's clan contains the elements of both Cameron and Quinn's clan and Cameron and Quinn's adhocracy is to some extent reinforced by Cameron and Quinn (1999) who see the clan and the adhocracy as sharing the goal of flexibility and discretion – while the adhocracy tends to be externally focused and the clan internally focused..

Thus the model put forward by Cameron and Quinn contains many similarities to the model put forward by Macintosh (1985, 1994) and Ouchi (1979).

Cameron and Quinn (1999) used the model to test the ability of organizations to manage change. They considered that as organizations develop, different internal cultures are required at different times in the life of the organization. Thus, for example, Apple Computers was initially a very innovative company that ran as an adhocracy, but as its products matured, the ad hoc nature of the operation clashed with the need to have a stable manufacturing base in order to meet the market demand. The organization responded by shifting to a market oriented culture. The result was severe friction within the organization, which eventually led to the founder, Steve Jobs, moving out into a consulting organization (Cameron & Quinn 1999).

3.6 The key to the future role of the internal auditor -

Corporate governance and the non-executive director.

Executive directors generally have very wide access to the operations of the organization that they are directing. As executives, they generally deal day-to-day with the problems faced by the organization and are aware of any shortfalls in the information systems of the organization. They are also generally aware of the state of the organization, and what it is doing.

Non-executive directors do not have day-to-day contact with the organization, and rely heavily on the board position papers.

These papers are generally prepared under the direct control of the executive directors. Thus the information submitted to the non-executive directors in board position papers is certainly not independent and may be biased. The problem for the non-executive director is to recognize when this is the case. Generally the board position papers will not contain significant bias. However some organizations with extremely strong executive directors may introduce bias to avoid admitting to particular difficulties within the organization.

To avoid being in a situation such as existed in *Morley's Case* the non-executive director needs an independent source of information as to what is happening within the organization.

The steady introduction of board audit committees has been considered a move in the direction of stronger corporate governance. In jurisdictions such as Singapore, these board committees are supposed to contain a majority of non-executive directors, and be chaired by a non-executive director (Singapore Stock Exchange Listing Rules).

The committees are generally reliant on senior management for the preparation of committee position papers. This means that they remain reliant on data that is under the direct influence of the executive directors. Thus the independence and lack of bias of the data cannot be guaranteed.

Audit committees often are the first point of contact in dealings between the organization and the external auditors. The role of the external auditor is defined under Australian law as to "form and opinion on the truth and fairness of the accounts" (Corporations Law). Thus the external auditors, with their duty to report this independent opinion to the shareholders, may be considered to be a potential source of information on the organization that is free from bias or error. As set out below, history however tells a different story.

There are many occasions in history where the external auditors have failed to alert anyone that the organization is in severe difficulties. Indeed, when H.G. Palmer Consolidated Limited failed in October, 1965 the resultant fallout included the imprisonment of the external auditor for a period of not more than three years (Clarke et al., 2003). Other examples include Reid Murray Holdings Ltd in 1963, Cambridge Credit Corporation in 1974, Bond Corporation Holdings Ltd in 1989 and HIH in March 2001, to mention but a few (Clarke et al., 2003). HIH failed shortly after releasing what appeared to be a sound set of audited accounts (Clarke et al., 2003). There is little to suggest that the external auditors undertook any action to warn either the non-executive directors or the public of the impending crisis. This phenomenon is not new. In England, The Leeds Estate Building and Investment Society Limited failed without proper warning from the auditors in 1882 (Dicksee, 1915). The London and General Bank Limited also failed in 1892 without proper warning from the Auditors (Dicksee, 1915). In Australia, similar fates befell companies in Australia such as the Mercantile Bank of Australia in 1892 (Fitz-Gibbon & Gizycki (2001) and Mount Morgan Gold Mining Company Limited in 1920.(Cosgrove, 2001) These are but some of the examples drawn from across the modern period when the external audit of company accounts has been normal and corporate failure was not preceded by any warning from the auditor.

Other recent failures in Australia where there has been little or no warning from the external auditor include International Finance Corporation Pty Ltd in 2003, Westpoint Corporation in 2005, and Opes Prime Stockbroking Ltd in 2008 (www.asic.gov.au), Thus the non-executive director is often out on a limb. Obliged to have a sound knowledge of the internal machinations of the company, but with no sources to provide this reliable information. The result is that often the non executive directors have failed to meet the apparently simple requirements established in *Morley's case.* This is because they have been unable to find a tool to use to meet this simple obligation.

To ascertain the depth of this problem, discussions have taken place with a number of non-executive directors, together with discussions with middle management in the organizations where the non-executive directors hold board seats. A point that will be analyzed in more detail later is the apparent gap between the perceptions of an organization's operations that the non-executive directors hold and that of the organization's middle management. It is almost as if the non-executive directors viewed the organization "through rose coloured glasses".

Given this situation, it would appear likely that non-executive directors could easily be misled as to the real state of the organization on whose board they sat. In other words:

- The organization's management are in a position to project the image of the organization that they want the non-executive directors to see.
- External auditors appear to have a mixed record in correcting the bias of such images.

So the question arises, where can the non-executive directors look for unbiased information about the organization.

Traditionally larger organizations have an internal audit function. This function has become sufficiently widely recognized to have developed its own professional body.

There are examples of strong internal audit roles that would overcome the above deficiencies, for instance the Board of Tourism Queensland sees its Audit Committee role to include:

"*Review, update and approve internal audit and external audit plans;*

Review internal and external report findings, recommendations and management responses;

Track management implementation of agreed internal and external audit recommendations" (www.tq.com.au, August 2008)

This gives the internal audit within the organization significant independence form management.

Further, the Board of Tourism Queensland has seen fit to include in the internal audit role the following:

"risk management processes

internal control effectiveness

*opportunities for process improvement" (*www.tq.com.au, August 2008*)*

These activities encompass an operational internal audit role.

The development of the Australian Securities Exchange guidelines for corporate governance have further enhanced the role and responsibility of the internal auditor into the future by taking a similar approach to that required by Tourism Queensland (www.asx.com.au, August 2008).

Considered logically the role of the board audit committee, just as the liaison point between the organization and the external auditors, would have to consider audit cost as a factor in how it handled that liaison. One way of reducing cost is to liaise with the external auditor as to the level of work that may be delegated to the internal auditor. This implies that the work activities of the internal auditor should be controlled by the board audit committee. Given that the board audit committee should be controlled by the non-executive directors, this means that the internal audit function will be reporting directly to the non-executive directors.

In summary, with a reasonable mandate, the internal auditor can be a wide ranging and a key source of independent information for the non-executive members of a board. For this to work, however, the non-executive directors must ensure the protection of the internal auditor. As mentioned before, internal auditors are often short-term appointments, who would be aware that they will be returned to the organization they have audited at the end of their tenure. If the board is to be effective in the use of the internal auditor, they must make the internal audit post contain a worthwhile career path.

CHAPTER 4

THE EFFECTIVENESS OF THE INTERNAL AUDITOR

There are two aspects that must be considered in evaluating the effectiveness of internal auditing; (a) what the internal auditor does; and (b) does the internal auditor undertake that role efficiently?

4.1 The role of the Internal Auditor

As stated earlier, the Institute of Internal Auditors set down a wide range of tasks that can be undertaken by the internal auditor (IIA Handbook,1997). These tasks range outside the conventional view of a narrowly defined financial role. The reason for this is that all actions within an organization will have a financial effect on that organization.

In considering the effectiveness of the internal auditor in any particular organization it is therefore necessary to consider how extensive the role of the internal auditor is. In evaluating this, however, it may be found that many organizations subdivide the role, and several separate functions may be carrying out various recognised parts of the role. This may be because management are concerned that the word “audit” may have negative connotations, and therefore using the word “audit” may adversely influence the way the organization’s members deal with that area. Thus when designing questionnaires, it will be necessary to draw these activities into the ambit of the area being considered.

4.2 The Question of Effectiveness

There are several ways of considering audit effectiveness. The General Services Commission of the State of Texas has developed one set of criteria, which are as follows:

1 At what level is management involved in the internal audit function. All reports should be dealt with at the highest level.

2 The internal audit function should be involved in the assessment of the entity's risk profile. In other words; what risks are faced by the entity and what damage can be done by these risks? These should be well documented and linked to the audit plan.

3 A properly drawn audit plan of action, reflecting the high risk areas of activity must be drawn up, and acted upon. In drawing up the plan, all expertise within the organization should be drawn upon.

4 The planning and conduct of the audit should be in conformity with professional standards, ie the standards of the Institute of Internal Auditors.

5 Communication of results must be to the highest authority within the organization, and action plans to correct deficiencies must be considered at this level.

6 Proper follow up of recommendations must exist.

7 That the various compliance requirements are adhered to. In the case of Texas State organizations, this includes compliance with the legislative requirements of the State of Texas, and the Code of Ethics of the Institute of Internal Auditors. (State of Texas, Auditor's Office, 1997)

The Texas Audit Office has gone on to detail its development of its own series of considerations to be used in deciding the effectiveness of an audit (State of Texas, Auditor's Office, 2000). These detailed considerations are summarised as:

1. Is the internal audit process planned in conjunction with both senior management/board and the line management involvement?
2. Are all risks properly identified and included in the audit process?
3. Is the risk identification undertaken at a sufficiently high level within the organization?
4. Is internal audit independent of day to day management operations?
5. Is the internal auditor sufficiently senior?
6. Is there a proper quality control procedure in place within the internal audit function?
7. Is the internal audit function recognised as important to the organization in that it adds value to the organization?

8. Does the internal audit function have a recognised role within the organization as an ethical sounding board?
9. Does the internal audit function have an effective procedure for establishing ethical guidelines?
10. Do the planning and procedures of the internal audit function conform with the professional standards?
11. Are the risks the business faces, and internal audit procedures reviewed regularly to ensure that the organization does not face unidentified risks?
12. Is the internal audit operation both properly managed as to cost, and properly funded?

(Texas Auditor's Office, 2000, Paraphrased)

These questions are a sound analysis of the requirements of an effective internal audit operation, and tie into the position taken by the IIA (IIA Handbook 1997).

Most of these points have been supported by academic writers for some time. For example, points 1, 2, 3, 4, and 5 above has been held out for some time as an important requirement of internal audit by Wilson and Root in 1989 (Wilson & Root, 1989).

Dhamankar & Khandewale (2003) have defined what makes an internal auditor effective as having:

i.) *the right outlook towards the function;*

ii.) *proper orientation about the role internal audit plays in the overall business set up;*

iii.) *understanding about real life difficulties; and*

iv.) *an urge to deliver the best.*

Dhamankar & Khandewale (2003) go on to recommend that

- *The appointment of the internal auditors should be made by top management, other than a person from the finance department,*
- *The authority should be delegated in writing in the form of an 'Audit Manual' and should be properly communicated to all concerned,*
- *The purpose of the audit and scope of the audit must be communicated to all concerned persons, if possible, the (sic) representative of all departments should be involved in the process of determination of scope of the auditors.*

It is unfortunate that Dharmankar & Khandewale appear to limit the role of the internal auditor to a financial one, by excluding the financial section from being involved in the choice of internal auditor. This is particularly so given that, as previously mentioned, the IIA would hold that the role of the internal auditor extends beyond a mere financial role to include operational auditing.

It is also unfortunate that they take the approach to selection of the internal auditor that they do, considering that they comment that "*Unfortunately the role of (the) Audit Committee…. does not include appointment of internal auditors*" Dharmankar & Khandewale (2003). The optimal position would be appointment of the internal auditors by the Board Audit Committee. In fact, such an action would not be new. The appointment of the head of internal audit within the ANZ Bank was a board decision as far back as 1972 (ANZ Bank Archives). One would have thought that Dharmankar & Khandewale would have encouraged the process. They do, however, suggest that: "*the replacement of internal auditors is also, to a large extent, driven by the desire to get rid of the person posing to be dangerous than by the desire to improve the effectiveness of the function."* (Dharmankar & Khandewale, 2003). Unfortunately Dharmankar & Khandewale make no attempt to justify or support this remark, and it therefore must be assumed that with the improvements in corporate governance demanded by the various developments such as the Sarbanes Oxley Act (2002), this situation is becoming irrelevant.

Since the passage of the Sarbanes-Oxley Act (2002) and the need for corporations registered in the USA (or for that matter, raising capital through the US capital markets) to have an extensive internal control system, the role of the internal auditor has moved in the directions put forward by all the above points. In fact there has been a substantial increase in the demand for internal audit as a result of this legislation.

Another approach is the "bloody minded" one of simply asking what losses have/have not been prevented by the designing and monitoring of internal control systems undertaken by the internal auditor. Chapter 2, at 2.4.1 illustrates the risk of loss in the event of a failure to have adequate control systems. This approach is covered in the "Texas" model (Texas Audit Office, 2003) by the question about risk identification and minimization which is also covered by Wilson and Root (Wilson & Root, 1989). . The fact of the matter is however that proper risk minimization must include proper risk identification and management, and in most organizations this is an operational question rather than a financial one. This the importance of the operational internal auditor (whatever he/she is called) in minimizing physical and therefore financial risk to the organization.

CHAPTER 5.

THE RESEARCH METHOD

The purpose of this chapter is to examine the available forms of research and explain why the particular approach used in the gathering of evidence was chosen. The chapter will also explain the type of cultural model chosen as a framework for the research, and how that was applied in the research.

5.1 Available Forms of Research

Before considering the available forms of research, it needs to be kept in mind, that the question of validity will arise whenever any research is being conducted. Results that cannot be demonstrated to be valid are of limited value.

Validity can be considered to have two dimensions; internal and external. Internal validity may be expressed as "a measure of the extent to which variations in the dependent variable can be really attributed to (or said to be caused by) variations in the independent variables…" (Abdel–Khalid and Ajinkya 1979) In other words; "how valid is the inference that causality exists." (Abdel – Khalid and Ajinkya 1979). External validity is "..the extent to which the results of any one study are generalizable to other samples, time periods, events, and so forth." (Abdel – Khalid and Ajinkya 1979).

There are several approaches to studying the problems discussed in the previous chapters. Each of these approaches has its own strengths and weaknesses. Smith (2003) sets out these approaches as:

Experiment

Survey

Fieldwork: Case Study

Multiple Case Studies.

5.1.1 Experiment

Smith (2003) accepts the definition given by Abdel–Khalid and Ajinkya (1979 p.31) as being a situation where "the researcher ….is (i) able to manipulate explicitly one or more independent variables and (ii) to assign (if not select and assign) Subjects to control or experimental groups (basically to achieve randomization)." The major advantage of the experimental method is that, as the Subjects are in a closed environment, exogenous distractions may be reduced, thus ensuring high internal validity (Smith 2003). Thus, experiments are suited to investigating causal relationships. The problems with the use of experimental methods in the study under consideration are related to the guidelines that Smith adopts from Gibbins and Salterio (1996) as being the keys to good research. Four guidelines are listed. The first three are fairly straightforward: a clear statement of the problem; clear understanding of the theory underlying the problem; and a soundly designed experiment. The fourth guideline, recognizing the importance of external validity, creates the need to have a realistic experimental setting (Gibbins and Salterio 1996).

This limits the applicability of the experimental method. Experimental methods may be applicable where the responses to a limited number of variables are being examined. However, when a large number of variables is being examined, an experimental situation that properly developed the output data to sufficient a level on a broad scale, and was externally valid, would be a vast enterprise that cannot be justified given the alternative methods of research available. Also, such an experiment, while possibly yielding internally consistent results, would require such extensive role playing by the participants, that a high risk exists that external validity may be lost. To obtain the depth of data would require the construction of a complete artificial organization to interact with the Subject(s) under investigation. Further, such a detailed level of role playing, with the Subjects facing a situation where "rewards and punishments" are known to be artificial, may result in the Subjects themselves "experimenting" to see what reaction they would cause within the artificial organization. Thus "in depth" experiments are fraught with the potential to be both internally and externally invalid. For this reason the approach was considered inapplicable for this research activity.

5.1.2 Survey

Smith (2003) discusses the survey as a further choice in research methods. The survey has several advantages and several disadvantages. A major disadvantage is that participants have the option to self-select out of the survey population. Thus, surveys may lack genuine randomness in the selection of which Subjects are assigned to which treatment. The result is the risk that internal validity may be threatened (Smith 2003). Also, for surveys to work effectively, the size of the questionnaire document needs to be considered. Too large a document may either reduce the level of responses or (worse still) create spurious responses, where (something akin to the donkey vote) the respondent may start with good intentions but then slip into "Tick mode" in order to finish the survey. Abdel–Khalid and Ajinkya (1979) put it this way; "….*the type of information that can be gathered accurately is of the surface or superficial variety. Surveys are usually not suited for the intensive study of a phenomenon.*"

Telephone surveys suffer from the dual faults that many respondents will either withdraw at the beginning or part of the way through, or give spurious answers in jest.

Face-to-face surveys overcome many of the above problems. They also allow the interviewer to explore problems in depth. When this happens, however, the survey is moving towards being field work.

It should be noted that organizational culture surveys, which, being a survey, are considered quantitative measures, are "*limited to the more observable and accessible levels of culture"*(Ashkanasy et al, 2000). Thus, attempting a quantitative approach using survey data will limit the usefulness of the data due to lack of depth. In fact, in considering the question of quantitative research as against qualitative research, Yin states that "*if Sampling logic had to be applied to all types of research, many important topics could not be empirically investigated"* (Yin, 2003, page 49).

5.1.3 Field work

Smith (2003) considers field work to cover a single case study or multiple case studies.

5.1.3.1 Case Study

Case study involves the investigation of a single organization either by an external observer or a participant in the organization's activities (Smith 2003). The major disadvantage of a case study is that the data gathered relate only to the case under investigation. Thus, the projection of findings is difficult to justify statistically (Smith 2003). Further, the possibility of bias cannot be dismissed, as the gathering of information is not free of exogenous effects, as would be the case in an experiment with a controlled environment. To some extent, though, experiments can rarely claim complete certainty that Subjects are unbiased, as exposure of the Subjects to exogenous variables prior to the experiment cannot be monitored and controlled (Abdel – Khalid and Ajinkya 1979). Additionally, as the researcher can respond to answers with further questions designed to assist with further analysis, the data gathered in a case situation will generally be more rich in detail and insight than either survey-based or experimental research.

5.1.3.2 Multiple Case Studies

Multiple case studies consist of comparative examinations in depth of more than one organization. While the increase in the population under study will tend to increase the validity of the study, generally, the depth of research limits the number of organizations under study such that no statistically significant statement can be made. Some comparative information, however, may be identifiable, that may allow the development of further hypotheses for testing. It is this comparative information that makes the multiple case study a valuable research tool. The information remains qualitative rather than quantitative but it will still extend the boundaries of knowledge.

Yin (1989, 2003) does not differentiate between the use of single case studies, and the use of multiple case studies. He sees such research as a key way to discover answers to the questions; how and why (Yin 1989, 2003).

5.1.4 The Case Study Process

Yin (1989, 2003) looks at the various forms of case study and concludes that case studies can be used as explorative, descriptive or explanatory tools. In particular, case studies can be used to look at the "what", "how" and the "why" in investigating phenomena. The critical element is the effective design of the case study.

The important elements of a case study are given as:

> *(1) a study's questions;*
>
> *(2) its propositions, If any;*
>
> *(3) its unit(s) of analysis;*
>
> *(4) the logic linking the data to the propositions; and*
>
> *(5) the criteria for interpreting the findings.*

(Yin, 2003, p21)

Each of these in turn is explained below:

5.1.4.1 The General Case Study's Questions

For a case study, the questions should be basic questions of "what, how and why", and must lead to the development of a set of propositions. Only once these propositions are developed is that case study able to move on, as they will define what is relevant. The one exception to this is the exploratory case study.(Yin, 1989,2003)

5.1.4.2 The General Case Study's Propositions

The propositions should cover in detail the important theoretical issues that the case will be used to test. Generally, they are propositions about the nature of the case and may include general propositions (Yin, 1989, 2003). The extent to which the propositions are restricted to just one case needs to be carefully considered. This will be elaborated on when discussing the question of logical linking of the case data to the propositions (Yin 1989, 2003).

5.1.4.3 The General Case Study's Unit(s) of Analysis

The unit of analysis is very important. The decision as to what is/are the unit(s) of analysis will guide the direction of the study. In most cases in which an organization is studied, the following decision has to be made; is the unit of analysis the individual, the sub-group within the organization or the organization as a whole. Different choices of the unit of analysis will lead to different interpretations of the data (Yin, 1989, 2003). It should be noted, however, that the case may have more than one unit of study (Yin. 1989, 2003).

5.1.4.4 The General Case Study's Logic that Links the Data to the Propositions

Traditionally, most data collected by the various methods of examining social situations rely on inference. The problem with inference is that it involves projecting limited data to the population with a claim of causality (George & Bennett 2005). While statistical methods may claim to be able to correlate events with great accuracy, they still rely on the assumption of linkage. Linkages may not exist in the manner expected (George & Bennett, 2005). This is a high risk in surveys, but less so in experiments, and is further reduced in case study situations. While the inferences made by a case study may be difficult to project generally, often the causal relationships can be more easily defined (George and Bennett, 2005, Yin, 1989, 2003). This makes the case study with its deeper richer data an important tool for exploring particular intra-organizational relationships that may have been altered by recent exogenous events.

5.1.5 The General Case Study's Criteria for Interpreting the Finding

To interpret the findings Yin (1989, 2003) considers the following key points must be covered:

Construct Validity, Internal Validity, External Validity and Reliability.

5.1.5.1 Construct Validity

This requires the careful selection and description of the area under study. Boundaries need to be properly settled at the design stage. The selected measuring tools need to be measuring the target variables (Yin 1989, 2003). This needs to occur at the study design stage (Yin 1989, 2003).

5.1.5.2 Internal Validity

In order to demonstrate a causal relationship, internal validity is required. However where a study is exploratory, internal validity is less important. It is the key to all inferences, be they the result of a case, experiment or survey study. There are two dangers. One is that in suggesting a link between two variables, a third (or fourth) that contribute to the outcome may be missed. The other is that the causal direction may be misunderstood (Yin, 1989, 2003). The solution to these two difficulties is to be found in the richness of the data that exists within the case (Yin, 1989, 2003)

5.1.5.3 External Validity

Yin (1989, 2003) also examines the process of generalizing case studies to support a theory. Often it is suggested that cases cannot be generalized, as no statistical evidence exists that enables the conclusions to be projected outside the case. The weakness here is that the surveys are different animals, they rely on statistical generalisations. Case Studies (as with experiments) rely on analytical generalization. (Yin,1989, 2003). Thus, according to Yin (1989, 2003) "In principle, theories….. would be the target to which the results could later be generalized." Abdel-Khalid & Ajinkya (1979) state that "Since field studies are conducted in a more realistic environment, external validity and the practical significance of the results is high."

Yin does, however, sound a note of caution: "However the generalization is not automatic. A theory must be tested through replications"(Yin, 1989).

5.1.6 Summary of Choice of Research Method

The richness of data underlying a multiple-case study approach helps better to determine causal relationships at least within the cases. Also, there is no evidence that the relationships under consideration have been considered in the manner proposed before. Accordingly, a case approach gives this study greater validity, both internal and external than a survey would. It also recognizes that replication of the real world in an experimental environment would be complex and of little practical benefit. For this reason the research method best suited to this study is a multiple case based approach.

5.2 Case Design

The explanation of the case design, will start with an examination of the model used in considering the culture of the organization.

5.2.1 Choice of Model

The culture of the organization to be studied is a key aspect of this research. Culture tends to be a reflection of a group's or individual's qualitative views of the world at large (Kloot, 1997).

The main models have been discussed in Chapter 4**.** Hofstede's model has been validated (Hofstede 2003) as a test of the effect of certain aspects of country culture on the changes in management that may be necessary within divisions of the same organization operating in different countries (Hofstede 2003). Similarly, Ouchi used his model as an attempt to explain the difference between US corporate decisions and Japanese corporate decisions (Ouchi 1981). Cameron and Quinn have tested their model using different corporations based in the same country, all exhibiting the country culture of their base. As this study considers internal audit to be a sub-unit within an organization, this study is looking at organizational culture and organizational sub-culture from the viewpoint of organizational units within the same organization rather than sections of an organization operating in different countries, Cameron and Quinn's model appear to be the more suitable choice of cultural model.

Quinn et al (1996) developed a model of organizational culture in which they considered four recognizable forms of organizational culture. This was the competing values model. This model assumes that organizations face a series of conflicting decisions and the decisions will be made on the basis of the importance to the organization of certain values. This was developed further and a tool to analyze an organization's culture in terms of the model was developed by Cameron & Quinn (1999).

Cameron and Quinn (1999) have developed a questionnaire, based on the competing values model discussed in Chapter 3 at subsection 3.3, consisting of a set of questions designed to provide a cultural map of the key competing values within the organization. In the questionnaire they developed, each of the key cultural pointers is ranked. Thus, there are six sets of questions. Each set consists of four questions. Each of the questions is designed to have the survey participant consider the importance to the participant's organization of an aspect of one of the four cultural values that Cameron and Quinn consider are competing for the organization's support (Cameron and Quinn 1999).

Cameron & Quinn (1999) state that the competing values framework was "empirically derived, and has been found to have both face and empirical validity". They go on to say that:

> *"the competing values framework has been found to have a high degree of congruence with well known and well accepted categorical schemes that organize the way people think ….Similar schemes have been proposed independently by… Jung(1923), Myers & Briggs (1962), McKenny & Keen (1974), Mason & Mitroff (1973) and Mitroff & Kilmann (1978)".*

They also (1999) state that the questionnaire set developed by them has been used in a number of organizations, and the interpretation of the culture within each organization has been identical across all members of the organization. Thus the questionnaire appears to be internally valid.

In developing their questionnaire, Quinn (1996) and Cameron & Quinn (1999) take the view that there are four approaches to managing organizations, leading to four organizational cultures, as follows:

1. Aim to expand and adapt. This is considered to result in a culture of *adhocracy.*
2. Aim to consolidate and control the organization. This is considered to be the opposite to Approach 1 above (*adhocracy)*, and to result in a culture of *hierarchy*. (Quinn (1996) used the same definition to describe a *professional bureaucracy.*)
3. Aim to maximise the competitive position of the organization in the market. This is considered a *market* culture.
4. Aim to satisfy the human needs of the organization. This is considered to be a *clan* culture.

Cameron and Quinn (1999) consider that while the four approaches appear theoretically to be mutually exclusive, it is possible that any one organization may have partial goals that embrace each different cultural aim to some extent without completely excluding the other cultural goals. Because these goals are in competition with one another, hence, the competing values concept. If these cultural aims or values were set as quadrants to a circle, in the order 1,3,2,4, then this circle could be considered an integrated model of management. Each quadrant would, in their opinion, represent the opposing set of values to the values shown in the diagonally opposing quadrant.

Particular management traits or values could be allocated towards the segment that suited them. In some versions of the model, this has resulted in the model having a series of spokes or rays (or lines emanating from a central point). Each ray represented a particular competing value or management trait. The strength with which each particular value was held could be measured using a scale, plotted radially. The predominant culture of the organization could then be recognized by the weighting of particular values in that quadrant.

Cameron and Quinn (1999) have simplified the method of measuring culture that is developed in Chapter 3 into six four dimensional questions. This gives four lines emanating from the central point rather than many. Each question is allocated a score of 100 points and these points have to be allocated between the four dimensions of the question. Each dimension is a description of an aspect of one of the four cultural goals that is raised by that particular question. Each dimension is allocated a share of the 100 points belonging to that question according to the level of importance to the organization of that goal with respect to that question.

Each of the six questions is worded such as to identify a key aspect of organizational culture in terms of the four dimensional model.

Thus, each of the six questions consists of four simple descriptions of that aspect or characteristic of one of the four cultures recognized by Cameron and Quinn. The descriptions given by Cameron and Quinn (1999) are:

"*1.Dominant characteristics:*

The organization is:

(a) a very personal place. It is like an extended family. People seem to share a lot of themselves.

(b) very dynamic and entrepreneurial. People are willing to stick their necks out and take risks.

(c) very results oriented. A major concern is with getting the job done. People are very competitive and achievement oriented

(d) a very controlled and structured place. Formal procedures generally govern what people do.

2. Organizational leadership:

The leadership is generally considered to exemplify:

(a) mentoring, facilitating or nurturing

(b) entrepreneurship innovating or risk taking

(c) a no-nonsense aggressive results oriented focus

(d) coordinating, organising or smooth running efficiency.

3. Management of employees:

The management style in the organization is characterised by:

(a) teamwork consensus and participation

(b) individual risk taking, innovation freedom and uniqueness.

(c) hard driving competitiveness, high demands and achievement

(d) Security of employment, conformity, predictability, and stability in relationships.

4. Organizational Glue:

The glue that holds the organization together is:

(a) loyalty and mutual trust. Commitment to this organization runs high

(b) commitment to innovation and development. There is an emphasis on being on the cutting edge

(c) the emphasis on achievement and goal accomplishment. Agressiveness and winning are common themes.

(d) formal rules and policies. Maintaining a smooth running organization is important.

5. Strategic emphasis:

The organization emphasises:

(a) human development. High trust, openness and participation persist

(b) Acquiring new resources and creating new challenges. Trying new things and prospecting for opportunities are valued.

(c) competitive actions and achievement. Hitting stretch targets and winning in the marketplace are dominant.

(d) Permanence and stability. Efficiency, control, and smooth operations are important.

6. Criteria for success:

The organization defines success on the basis of:

(a) the development of human resources, teamwork, employee commitment and concern for people.

(b) Having the most unique or newest product. It is a product leaer and innovator.

(c) winning in the marketplace and outpacing the competition. Competitive market leadership is the key.

(d) Efficiency. Dependable delivery smooth scheduling and low cost production are critical.

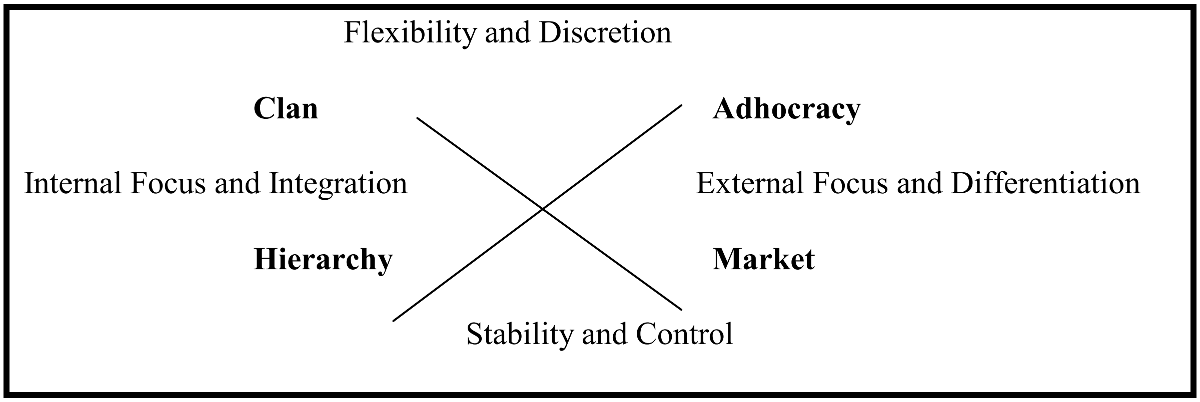
(Cameron and Quinn, 1999 pp20-22 paraphrased)

Thus, with each participant asked to assign a score of 100 points to a question, and then divide those 100 points across the four alternatives in the question scoring the alternatives on the basis of level of importance to the organization 600 points are allocated.

By adding the values assigned to each of the six characteristics (a)s, a total value for "Clan" can be obtained. Similarly, adding the (b)s gives a total value for "Adhocracy", adding the (c)s gives a total value for "Market" and the (d)s give a total value for "Hierarchy". These four values can then be plotted along four lines or "rays" radiating from a common central point. These four points can then be joined by lines to give a shape which indicates the dominant culture as shown in Figures 5.1 and 5.2.

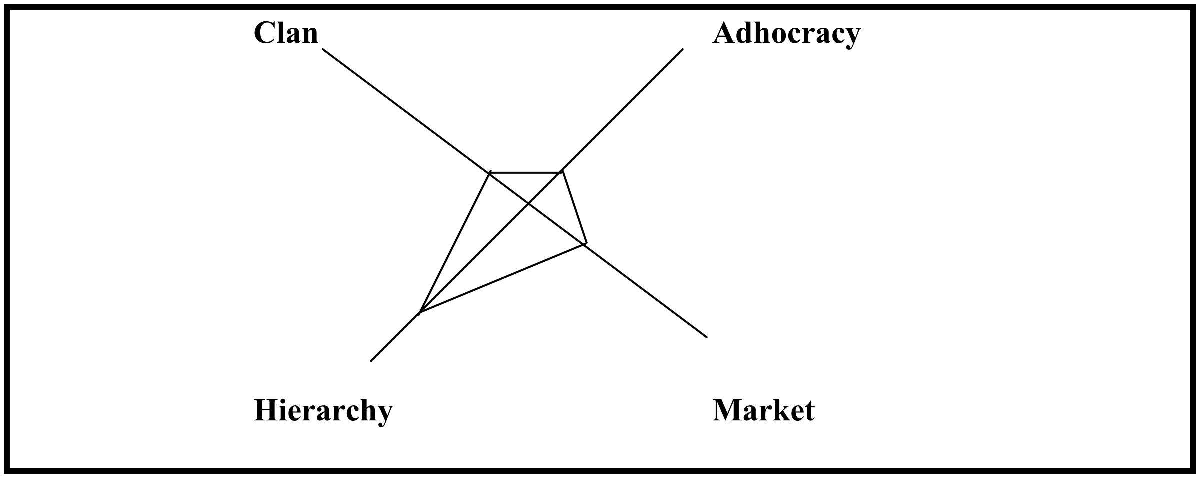
This simplifies the diagrammatic display of the outcomes from the joining of many rays into the complex web used in Quinn (1996) to a pattern joining four lines used in Cameron and Quinn (1999) as shown in Figure 5.2.

Figure 5.1 Cameron and Quinn's Cultural Model Represented Diagrammatically



The line along which the highest score is located is that of the dominant culture of the organization. For example, Cameron & Quinn (1999) describe the pattern set out in Figure 5.2 as a hierarchy.

Figure 5.2 Cameron and Quinn's Model of a Dominantly Hierarchical Culture



Two points can be noted from such a diagram. The first is which culture dominates. The second is the extent to which that culture dominates. In Figure 5.2, it can be seen that the hierarchy culture is dominant. It can also be seen that the other four cultural factors contribute to the organization but to a far lesser extent, and none act as significant secondary influences, each being about equal in level of importance in it.

Cameron and Quinn (1999) state that each organization will exhibit attributes of all the different cultures, but the attributes that dominate will be the principal driving culture of the organization.

This model has similarities to Ouchi's model. These similarities, and an explanation of the differences follow.

Ouchi's model is three dimensional, recognizing a bureaucracy dimension, a clan dimension and a market dimension (Ouchi 1981). Cameron and Quinn (1999) have the four dimensions set out in Figure 5.1. It should be noted that Quinn et al (1996) use the words hierarchy and bureaucracy interchangeably. In fact the descriptive questions set out above describe attributes that both Ouchi (1981) and Macintosh (1985) recognise as a bureaucracy. The principal difference between Ouchi's model and the "Competing values" model is the existence of the "Adhocracy" form of culture. It should be noted that the questions that are used to indicate adhocracy are questions on risk taking and technical innovation. The question arises; are the attributes "risk taking" and "innovation" sufficient to establish a separate culture, or are such attributes partially independent of the culture, or likely to be found in conjunction with other attributes that belong to a particular culture. They are really only two attributes and, empirically, can be found attached to a bureaucracy. This is known because Cameron & Quinn (1999) attach these attributes to NASA. NASA strongly exhibits all the attributes of a bureaucracy (Cameron and Quinn, 1999).

Accordingly, the method of measuring organizational culture set out by Cameron & Quinn (1999) can be used to measure organizational culture in terms of Ouchi's (1981) Bureaucracy/Market/Clan model.

The choice of NASA as a typical bureaucracy may be inappropriate in that NASA does not represent the typical civil bureaucracy for reasons that follow. A key factor is that on closer investigation the "bureaucracy" of NASA is not risk averse. Also NASA does not seem to be bound by its own rules. NASA is a large organization with a wide variety of activities. These range from research and development in the area of small aircraft, through interplanetary space exploration with unmanned vehicles to manned space flight. The "shopfront" of NASA, however, is its several space programs. These programs include the standard launch of both commercial and military satellites, as well as being the major USA contributor to the International Space Station project.

NASA has not been particularly successful with its commercial satellite launch program, with strong competition from both France and Russia and lesser competition from China. Its aviation programs have not been shining examples of success, the development of an economical upgrade of the light plane is behind schedule, and has funded the development of several business jets rather than the intended ultra safe and fast replacement of the Cessna 172. Its deep space probes have had mixed results. Some have been outstanding successes and some expensive flops. Thus its manned space program remains the lynchpin of its shopfront activities. Its manned space program, however, has deteriorated from being highly successful to being an unmitigated disaster. The disaster started to unfurl in 1988 with the failure of Launch 51L when a seal between booster stages failed and hot gasses escaped resulting in the destruction of the launch vehicle and all on board. NASA had launched when weather conditions were outside those permitted for launch by its own internal instructions. IN other words it was not following its own internal control procedures. The reason for the rule was not fully explained to the persons controlling the launch, and thus the potential risk was not properly understood. Initially, it was believed that ignoring these rules was one of the key contributors to the disaster, and procedures tightened to prevent a reoccurrence. However in 1995, a similar seal failure occurred, this time the hot gas jet seeping through the seal was pointed harmlessly away from the spacecraft (www.fas.org/spp/51l.html, 22/6/2005). Procedures were tightened again, but problems continued.

Launch 107 failed on February 1st 2003. During the launch debris from the external fuel tank that was discarded after launch struck the shuttle and damaged its heat shield. When the craft re-entered the atmosphere on 1st February, 2003, the damaged heat shield failed and hot plasma gas entered the aircraft through the damaged heat shield, melting the interior structure of one wing. It is interesting to note that, while engineers expressed concern that the craft may have been damaged during launch, no attempt was made to verify that there was no damage (www.NASA.gov, 22/6/2005). No proper risk analysis of the potential damage the debris could cause was attempted.

In both these cases, failures occurred that would not normally be permitted in a strong rules based bureaucracy. It is suggested that the underlying reason was that the organization, while bureaucratic is more akin to a military organization than a civil organization. The fact that much of its work was and is classified as secret, and that many of its staff have military backgrounds, means that the organization is more like an army than a public corporation. Armies may be considered classic examples of bureaucratic organizations. They do however breed a peculiar attitude, which may be summed up as the saying that is considered anathema to normal bureaucracies (see section 3.1.9): “Rules are made for the obedience of fools and the guidance of wise men.” (Bader, 1954). Thus the rule is not seen as inviolate. The military bureaucracy is what could be called a “risk averse risk taker”. Military organizations will look to the desires of the commander-in-chief for leadership guidance. In both the above launches, decisions were made to fit the perceived needs of the perceived “commander-in-chief”. NASA tends to take “calculated risks" to achieve its goal. Further, such organizations value loyalty to the organization above all else (including common sense). Thus persons who believe a decision is inappropriate may only criticize internally. To criticize externally is to be ostracized. This is common not just in bureaucratic cultures. It is a general rule of human nature that an insider who criticizes members of the group to outsiders will be so treated (www.trinity.edu/rjensen, December, 2005). That is why whistleblowing is so rare that it is not found in the current MS Word spellchecking dictionary. For these reasons, NASA is not a good example of a normal rules-based bureaucracy.

Cameron and Quinn (1999) state that they have used the "Competing Values" model described earlier on several occasions to analyze the culture of organizations that appear to be dysfunctional, and developed solutions to the organizational dysfunction based on the concept of rebalancing the relationship between the four cultural variables.

Cameron and Quinn (1999) also state that using the model discussed earlier in this section they have had internally consistent results having used the model on over 1000 organizations, with the one minor point: That, at the level of the CEO and above, the interpretation of the strength of the clan values of the organization are significantly higher than for the rest of the organization. This is in line with the finding mentioned in chapter 3 (section 3.5) At all other levels, results have been consistent. This study therefore restricts itself to operational internal auditors and line managers. In the organizations studied the operational internal auditors and line managers are ranked significantly below the CEO and board. In fact, in the organizations the CEO has been chosen on the basis of organizational skills, and no CEO has operated the type of transport equipment used by the organizations.

If the above is accepted, then selecting the Cameron and Quinn (1999) model as set out earlier in this section of competing values as the method of measuring culture within the organizations selected for study is acceptable. The closeness of the Cameron and Quinn (1999) model to the model proposed by Macintosh (1985) and Ouchi (1991) supports this position. Thus, for the purposes of recognizing the culture of an organization, a questionnaire was developed to provide cultural ranking information similar to that which would be obtained by the use of a Cameron and Quinn questionnaire as set out in Cameron and Quinn (1999).

5.2.2 Difference between a Standard Cameron and Quinn (1999) approach and the One Taken in the Cases under Discussion

The principal difference was in the method of scoring. The same value-judgment questions were asked, but instead of asking the respondent to allocate 100 points across all four statements relative to each of the six questions, the respondent was asked to evaluate the extent to which he agreed or disagreed with each statement individually on a seven point scale ranging from strong agreement, through neutral to strong disagreement. Thus, the maximum score each of the four competing cultural attributes could obtain was 42 and the minimum score was 6. The reason for selecting a positive (6) as a minimum score was to avoid plotting through the origin. A neutral position would be indicated by a score on the ray under consideration of 24. Thus, where a respondent scored a particular attribute of their organization's culture at below 24, that attribute was to be considered a less important influence within the organization. Where a score of greater than 24 was achieved then that attribute was of greater importance in determining the organization's culture. The further below 24 a score, the more opposed to such an aspect the organization's culture was. Thus, when an organization that scored, say, 6 for the six questions designed to draw out its hierarchical tendencies, would be positively opposed to hierarchical cultural activities. While an organization that scored 42 would be positively in favour of hierarchical activities. Further it was possible for an organization to record a strong preference in favour of more than one of the cultural measures without this reducing the strength of the preferences recorded in favour of any of the other cultural measures. It is considered that this reduces the potential for bias towards the dominant cultural measure, where and organization is strongly influenced by aspects of one of the other cultural measures. Comparing the two scoring methods in simple terms: Take two example organizations that appear identical in culture using the Cameron and Quinn (1999) method of scoring. each having a 30% weighting down the Hierarchy ray and 30% weighting down the Clan ray with 20% weighting down each of the other rays.

Now let us suppose that these two organizations are scored using the 7 point scale down each ray.

Organization A. may score Hierarchy = 3, clan = 3, Adhocracy = 2, Market = 2.

Organization B. may score Hierarchy = 6, clan = 6, Adhocracy = 4, Market = 4.

Organization B is very different to Organization A, because it holds all its values with greater strength than Organization A. The strength with which an organization holds a particular value will often dictate how the organization reacts to events that affect that value. In simple terms, Organization B holds all its values with more enthusiasm and commitment than Organization A.

By using a scale instead of an apportionment approach to measure the cultural preferences of an organization, the result is that strength of preference is shown. In other respects the outcomes are identical to the outcomes that would be achieved by Cameron and Quinn (1999). Thus, in interpreting the data, the same approach as taken by Cameron and Quinn (1999) may be taken, however, the data may also be interpreted to confirm the enthusiasm and commitment with which any of the four cultural attributes is embraced.

5.3 The Decision to use a Multiple Case Approach

A survey approach was considered for this study. The nature of the organizational culture is a key part of the discovery process of this study. Each survey set returned would reflect a separate set of organizational culture outcomes, as each organization would have its unique culture, and the set for each organization would have to involve both an internal auditor and a line manager. It was considered that the risk of mismatched answers, when combined with the lack of detail as regards the operational responsibilities of internal audit that a survey would provide, would significantly weaken the study. The need for richer data implied a comparative case study approach would lead to a more satisfactory analysis of the audit and line management roles within an organization. Aggregation of results would weaken this analysis. Thus it was considered that an ordinary mail survey would not be appropriate. As a result, a three case approach was considered necessary for this component of the research. The consideration of a survey approach did however assist in that it gave a useful *aide memoire* tool for the gathering of data. Minichiello et al. (2008, page 89) emphasize the need for such a tool when they comment:

"*The in-depth interviewer needs to remind him or herself of certain areas which need to be discussed in the interview session/s. The researcher does not suddenly become Superman or Wonderwoman by virtue of the fact of choosing to engage in in-depth interviewing. The researcher does not suddenly gain a flawless memory which can retain all the necessary information to be remembered in the interview setting. Rather, it is recognized that in such a predicament, the researched utilizes the means at hand to do a good interview."*

Minichiello et al. (2008) is supported by Yin (2003, page 46) who states that the heart of a case study "*is a set of substantive questions reflecting your actual line of inquiry."*

The multiple case approach is considered a valid approach by Yin (2003, page 46) who says that "*The same study may contain more than a single case. When this occurs, the study has used a multiple-case design"*.

Yin (2003, page 46) considers that *"Multiple case designs have distinct advantages…"* and goes on to state that "*The evidence from multiple cases is often considered more compelling…"*

Yin (2003, page 49) also states "*if a sampling logic had to be applied to all types of research, many important topics could not be empirically investigated."* Yin (2003) also states "*if a sampling logic had to be applied to all types of research, many important topics could not be empirically investigated.*"

To maintain comparability, three organizations within the same industry were selected for study. The aim was to obtain data on any differences that may exist between organizations with the same basic operating requirements. Also by being in the same industry, industry operational factors should not be a causal factor in any differences in culture that may exist between the two organizations. Given that the intention was to study the influences and role of internal audit, the choice of organizations within each industry group was limited, as only larger organizations within all groups had a functional internal audit operation. This further limited the approach to be taken to a multiple case approach. It was also considered desirable to choose organizations of similar size so that size would not be a significant influence on the study's outcome.

5.4 Interpreting the strength of the Internal Audit within the Organization.

Having determined the nature of the organization's culture, the next step is to determine the nature and form of internal audit within the organization. This is a two part question. The first part involves determining the structure of internal audit within the organization. The second part is concerned with the power or authority of the internal audit within the organization.

As discussed in Chapter 4 section 4.1 and following, internal audit encompasses a broad range of activities. Often, individual organizations would have arranged these functions

for their own convenience, such that the activities may often be segregated within the organization and not viewed collectively as part of the internal audit function of the organization. Thus, a formal questionnaire without detailed guidance would be unlikely to yield a valid outcome. For this reason, a detailed structured interview becomes necessary. For this and the other reasons laid down, a form of continuing structured interview was considered the most appropriate method by which data could be gathered.
This combined with the limitations that ongoing structured interviews of personnel in a large number of organizations present, reinforced the decision to limit the activity to a small number of companies.

It was considered possible however that cultural differences would be found between the subject organizations so the second set of questions within the questionnaire was designed to measure the culture of each organization.

In analyzing the role, influence and strength of the internal audit function within the cases, 24 points were considered to be important. Each point was dealt with by a question. How these questions, designed to draw out the attitude of Subjects, were worded can be seen in Appendix I, setting out the questionnaire. The questions asked a Subject to express a level of agreement with the statement ranging across 7 points between strongly agree and strongly disagree. The purpose of each of the questions was twofold. The first purpose was to measure the Subject's perception as to how the Subject's organization dealt with a particular aspect of internal audit and internal control. The second purpose was to act as an initiator of discussion in the area questioned. Thus, as the Subject selected a value, the Subject was asked to explain the underlying reason behind the choice. An outline of the questions and their purpose follows.

The first question set out to determine the level of importance the organization gave to this internal audit function. It did this by a simple direct approach of asking if the board and senior management were involved in the management of the internal audit function.

The second question considered the role of this internal audit function in managing the risks the organization faced relative to this internal audit function's area of operation. It asks the Subject to measure the extent to which it is considered that all risks are properly identified and included in the audit process.

The third question considered how high an organizational level was involved in identifying the risks relative to this internal audit function. This question does not specify the appropriate level of management at which any risk should be assessed, it simply asks the Subject to state the extent to which the Subject is satisfied that the risk identification process occurs at a sufficiently high level of management within the organization. In determining the adequacy of this level there are two considerations which are not separated. One is the aspect of the risk, the other is that aspect of what is an appropriate level of management. In other words, for what is seen as a minor risk, a low level of management may be appropriate, for a major risk a higher level of management may be appropriate. The Subject is really being asked to balance these factors in considering what is the appropriate answer.

The extent to which line roles were distanced from the internal audit role was considered by the fourth and fifth questions. It is a traditional view that to function properly the internal audit should be independent of the target auditee (IIA Handbook, 1997). The fourth question is concerned with the appraisal of the level of independence. This is a perceptual question, in that a Subject is considering whether the independence of the auditor is perceived by the Subject to be adequate. It does not consider the question of independence as being a situation created by the level of rank of the auditor within the organization. The fifth question considers the level seniority of the auditor within the organization.

The fifth question related to the level of seniority within each organization of persons who were involved in the internal audit type of functions. It was explained to the Subjects that the nature of the internal audit encompassed operational internal audit. The Subject was required to consider if the level of seniority of the internal auditors was adequate for them to carry out their function. Again this is a perceptual question, as the Subject is being asked if they consider the level of seniority of the internal audit adequate, rather than “what is the level of seniority of the internal auditor”.

The sixth question considered the extent to which the Subjects within the organization regarded the internal audit type function as being quality oriented internally. In other words; were the internal auditors (including operational internal audit) Subject to quality control themselves. This has implications for the reliability of the internal audit outcomes, especially in an operational internal audit environment, where failure to properly establish standards will significantly degrade the ability of the operational internal audit to ensure that appropriate standards are maintained within operational areas.

The seventh question asked Subjects to consider the extent to which the organization recognized the internal audit type function as adding value to the organization. This question implied that if the organization considered the value to be nominal then it was only accepting the function as an activity imposed on the organization by outside parties such as government, or liability insurers.

The eighth and ninth questions were designed to probe how the organization dealt with ethical problems that they may face in the day-to-day operation. Question eight was designed to discover if the organization recognized ethical problems. Question nine was designed to discover the importance the organization placed on the solution of ethical problems.

Question ten was designed to discover the extent to which the organization recognized professional standards that would usually be imposed by outside professional bodies, as having a place in the governing of the behaviour of its employees.

Question eleven further examined the organizations attitude to business risk, in particular, whether business risks and procedures were constantly reviewed with an eye to improvement.

Questions twelve to fourteen are designed to draw out the organization's attitude to internal audit.

Question twelve directly asks the Subject about the organizational view of the cost effectiveness of the operational internal audit function. That discovers if the organization sees value in the current operational internal audit. A negative answer implying that the Subject considers that the organization does not see value in its internal audit activities including the operational internal audit activities.
Questions thirteen and fourteen indirectly attempt to find out if the internal audit function is considered important by asking if the organization considers the internal audit function to be important enough to be involved in the design of internal controls. There is a risk here that if the organization does not consider internal controls to be important, then the design my well be delegated to the internal audit function by default. Question thirteen asks about the financial controls. Question fourteen asks about the non financial control systems. In answering these questions, the Subjects were instructed to consider internal audit to cover all audit type activities conducted by persons other than the organization's external auditors. It was explained that this specifically included operational audit activities as well as financial audit activities.

Question fifteen sought to discover the extent to which control self assessment was used within the organization. The question was directly worded as it was expected that at this level of management, an understanding of the conceptual meaning of the term "Control

Self Assessment" would exist. Question 20 tested this expectation by asking the question without using the terminology.

Questions sixteen, seventeen, eighteen and nineteen were designed to establish the extent to which controls were properly documented and followed. They were tested by questions twenty-three and twenty-four, which asked directly if all "procedures" were properly documented, and if "procedures" across the organization were standardized.

The implication of lack of documented standardized procedures flows form the concept that controls need to be built into the normal operational procedures of the organization. Thus the failure to have properly documented procedures and the failure to follow these procedures meant that it would be highly likely that control procedures were either not being followed, or did not exist. Control procedures as stand-alone documented procedures are of little value compared to control procedures that are incorporated in the ordinary operating processes of the organization (Schelluch et al, 2004).Thus a positive answer to question seventeen would be seen as of little value unless accompanied by a positive answer to questions twenty-three and twenty-four.

Question twenty was designed to discover the validity of the answer to question fifteen. This was because the term "control self-assessment" used in question fifteen is terminology with a particular meaning, peculiar to the accounting and auditing profession, and may not be properly interpreted by persons who were not trained as accountants. Question twenty therefore asked the same question in plain language, as question fifteen without resorting to terminology.

Question twenty-one aims to discover if the internal audit role has access to the highest part of the organization, the Board. If it does not, then its role is limited to a management function. An internal auditor restricted to this limited role (operational or otherwise) cannot be considered to be regarded by the organization as holding as important function as an internal auditor who has direct and immediate access to the board, Obviously it would be generally possible for the internal audit function to make some approach to the Board, by direct external appeal to the members if necessary, but this would not be routine. Thus a ranking scale reflecting the ease with which the Board interacts with the internal audit function can be used.

Question twenty-two and twenty-three asked if the internal audit function was seen as protecting the organization from loss, either financial or non financial. These questions were designed to draw out the level of importance attached to internal audit as a process within the organization from a direct operational perspective. If the organization considered that the internal audit was of value as a protective device, it would rank progressively higher, as that level of value was considered greater and greater.

Question twenty-four is designed to confirm the completeness of documentation relative to the general running of the business. Obviously a control system that is well documented will exist within a well documented set of procedures. If documentation is weak, then it is doubtful that controls will be properly documented. Thus this question, as well as standing on its own merits, will test the answer to question 16.

Question twenty-five is designed to review the organization's attitude to itself as a whole, and discover if the organization has a common set of rules by which all its operating divisions function.

Overall the questions were designed to encourage discussion by participants, while providing a base input.

5.5 Comparability of Data

To assist with the comparability of data, it was decided to restrict the organizations selected to one industry and to choose organizations of comparable size within that industry.

Accordingly three organizations operating within the transport industry were chosen for analysis. All the organizations turned over in excess of $1 billion in sales in the year prior to the analysis, and all the organizations employed (directly or through subsidiaries) in excess of 5000 employees.

As stated previously, internal audit means different things to different people. For the purpose of the analysis, internal audit was given the widest possible meaning in terms of the ambit of claim made by the Institute of Internal Auditors (IIA Handbook, 1997). The claim that this form of work is the role of an internal auditor is reinforced by the Institute of Internal Auditors Implementation Standard 2120.A1 (Assurance Engagements) which states that internal audit should cover “effectiveness and efficiency of operations” and “compliance with laws” (www.theiia.org 2008).

Sections of the organizations that were not called internal audit, but carried out what could be considered an audit type of function in terms of IIA Handbook were treated as internal audit. Accordingly, all procedures undertaken to see that controls and control procedures were followed were regarded as internal audit activities for the purpose of the study. The result is that the study has not taken a narrow view of the role of the internal auditor, and has accepted persons who conducted surveillance to ensure that procedures that protected the organization from physical loss that would lead to financial loss were included as internal auditors.

CHAPTER 6

RESULTS

Three organizations were examined which faced three different regulatory authorities. The regulatory authorities ran along different lines, however, many of the regulations they enforce are common in order to facilitate the operations of organizations as they move across different regulatory domains. Most organizations within the industry run services across several regulatory domains, and it therefore becomes important for the smooth operation of the industry that all organizations face a basically common set of rules and procedures as they move between the several regulatory domains in which they operate. Regulators, recognizing this, have put considerable effort into producing a near common set of regulations and procedures across the several jurisdictions in which this industry operates. Thus, with some minor differences, the three organizations, which operate in the same states, even though they may be based in separate states, face very similar regulatory requirements, as they move from state to state. They also face very similar operational conditions.

In all organizations access was provided to two Subjects, one being a line management person and the other being involved in the operational audit of line operations. For the purposes of convenience, the three organizations will be known as Organization 1, Organization 2 and Organization 3.

The Subjects within the organization that provided data for the research will be referred to a Subject 1 for the operational internal auditor, and Subject 2 for the line manager for each organization.

The method of data collection was by way of structured interview using the questionnaire set out in Appendix I as a basis for the interview, thereby giving structure to the questions. Data were collected by way of notes, as the six interviewees wished to maintain absolute confidentiality, and did not wish to be recorded. The responses to each question are recorded in the rest of this chapter. The concept of Generalized Informational Privacy as elaborated by Turilli (2007) was used as a basis for the interview protocol. The principal approach was to guarantee absolute privacy to the interviewees, while at the same time maintaining data integrity.

6.1 Organization 1

Organization 1 is a large organization headquartered within one state, but operating across several states. The organization is a leading organization in its particular sector of the transport industry.

6.1.1 Organization 1, Subject 1.

The principal Subject (hereafter called Subject 1) interviewed from Organization 1 was until recently the Manager of Research and Development at an organization that was taken over by Organization 1. Arriving at Organization 1 the Subject was put in charge of the operational auditing of a group of small subsidiaries that had become part of Organization 1 as a result of the merger. The Subject thus had wide operational experience outside Organization 1. The Subject was also able to bring a different and relatively independent view of operational risk and the roles of operational auditing to the organization than that which existed within the organization.

In Subject 1's view the management of Organization 1 were convinced of their own superior competency in all aspects of the type of operation in which they were involved. This meant that they were certain they knew the right way to do everything. This included:

1. Knowing how to manage transport operations that involved short distances (short haul), a field which they had not been involved in for almost half a century.
2. Knowing better than the multinational companies that supplied their operational equipment the limitations of this equipment.
3. Knowing how to manage local (regional) transport operations, a field that they last ventured into before World War II.

He found that they had much experience in long-haul transport operations, which have particular requirements in training and management. At this art they were generally very competent. However, they were of the opinion that they knew better than most all aspects of the transport industry that they were involved with, be it long haul, short haul or regional distribution.

Subject 1's primary operational audit role was to audit line transport operations of certain parts of the organization and in particular certain of the subsidiary transport operations. In this regard he was not alone, as in effect any auditor could audit any section of the operation, regardless of their experience in such a section. Generally this did not happen often, and it was left to him as the specialist in these types of operation to conduct the audits. On occasion, however, other auditors, who generally audited the main transport operations, became involved in the audit of subsidiaries. When this happened, it often caused some ill feeling between auditor and auditee, as disputes over various procedural differences between the subsidiary's and parent's operating techniques arose. Often the procedural differences related to the different equipment used within the subsidiaries' operations.

Another problem was that the auditors, being highly experienced operators, often took charge of the operation they were charged to audit. They did this for several reasons. If they saw significant failure they considered they were obliged to take charge. Another reason was that such an action answered the need to maintain their own skill/experience levels. Other reasons included contributing to cost savings for the organization and to demonstrate, thus acting as a training tool. This muddied the distinction between the auditor and the auditee. Following one unfortunate incident, a government audit of the organization's compliance with various safety regulations was undertaken. This government audit of the organization expressed the situation it found within the organization this way:

"The …… (Government) audit noted that (auditors) who were actually (controlling the process) carried out a large percentage of the internal (audit). The reviewers believed that this was not an adequate (audit) method. Instead the (auditor) should be observing the whole operation and not conducting it. The report noted that the amount of (audits)

being conducted … was below the agreed target levels." (Source not disclosed to preserve confidentiality).

An indication of the regard which the senior management of the organization placed on internal audit was that during the period under review the organization went so far as to devolve the duties of its internal audit operation within its line operations. Audit personnel, however, remained audit personnel, they simply reported to line management rather than senior management or the board (Source not disclosed to preserve confidentiality). It was considered by Subject 1 that this was a retrograde step.

The operational internal audit department that devolved to line management, although not called an internal audit department, was effectively an operational internal audit department and was responsible for:

1. Setting procedures to maintain the safety standards relative to the transport operations This involved building in suitable controls to ensure safe operations. On the devolving of the operational internal audit department, it was assumed by the organization that this process would be managed by government fiat.
2. Inspection of line transport activities to ensure that these control procedures were adhered to.

In effect the department was an internal audit department responsible for operational safety and conducted safety audits to discharge their responsibilities (Subject 1).

Thus, this department and later after devolution, the former members on an individual basis, undertook activities which fell within the extended definition of internal audit as laid down by the IIA (IIA Handbook), and would be considered by the IIA to be part of normal internal audit. For this reason the operations of Subject 1 are considered to be in the nature of internal audit.

The following points should be noted:

1. The organization was strongly hierarchical, and members were “extremely protective of their turf”. This situation extended to, and within, this operational internal audit department’s members.

2. The operational internal audit department had no direct access to the board.

3. Operational internal audit personnel were unique within the organization, as, while employed by the organization, they were authorized to hold the positions they held by both the organization and government licence. Thus, an attempt by the organization to remove these personnel under protest and without good excuse, would be “messy” although not impossible.

4. Point 3 gave rise to a situation where they were relatively independent in their own activities despite only reporting to line management.

There were, however, problems with the government agency that monitored the safety aspects of the line operations of the organization. Two of these problems are elaborated below.

The government agency charged with monitoring the safe operation of the organization suffered from the weakness that at least since the 1970's a combination of its own internal rules (not allowing the organization to employ persons with specialist skills unless they met all health requirements, thus preventing them from employing retired skilled personnel coming from the sector they regulated) and low salaries, had resulted in the loss of personnel skilled in the specialist operation they were charged with monitoring. This was further exacerbated by the removal from the agency of their own practical operations. Up to the early 1990's the government agency had operated its own set of transport equipment of similar performance to those used in the industry as calibrating equipment, so that it could provide guidance and instruction to the industry regarding the operation of its equipment. From the early 1990's, partly as a result of the realization that as it currently regulated the industry, the government agency risked unfortunate litigation, this role was delegated to outside operators. Thus the skills that had existed within the government department disappeared quickly.

The second difficulty was that the government agency, for various reasons, was being converted to a police authority, where both the construction of highly complex regulatory requirements, and their enforcement was being required by the parliament of the state in which it was registered. Thus, the same organization was both making the rules and responsible for enforcement. This was further combined with a fear of common law legal liability or political backlash, if the organization was not seen either to have made adequate rules, or adequately to enforce these rules. This tended to encourage a draconian approach. Fortunately the draconian approach was tempered by the need to delegate to the operational auditors employed by the organization.

Returning to the organization we find that a walk out by the key audit personnel would instantly force the government to close the organization down, at least temporarily. They held the government approvals personally, and as such THEY were the operation. They thus wielded considerable coercive power. Thus, it was important for the organization to develop within this group a strong sense of organizational belonging.

The operational internal audit department did not communicate within itself in any practical manner. Personnel selected from the “brighter” members of those Subject to monitoring were trained up by other personnel to perform audits then just let loose. The only monitoring were two regular checks that these personnel performed on each other during the year. Other than that, no checking was undertaken of the activities of any operational internal auditor. Further, auditing of all the operational processes was very informal. Assignment was based on a system of bidding, in which all member auditors participated, the organization then awarding auditing activities to the various members based on a mixture of seniority and the level of interest in the different organizational activities shown by each operational internal auditor. Sometimes the expression of interest may have been due to a personal desire by one auditor to obtain transport to a particular location. He would then ask for that trip on the day he wished to travel to that location. The result was that often an operational internal auditor would audit an operation with which he had little familiarity. Such actions could have both benefits and drawbacks.

This operational audit existed as part of line management and thus when it disappeared into line management, the event was hardly noticed. Personnel assumed an audit role within the organization as a result of appointment by the regulatory authority on the advice of the organization.

The operational internal audit was charged with seeing that both the Government's regulations, and the organization's internal procedures were followed. The Government's regulations included operational instructions that the government agency had approved. The organization had several different operations that had their own government approved operational instructions. As stated earlier this tended to create confusion.

6.1.1.1 Subject 1's Questionnaire Responses about Operational Internal Audit Culture

The values for the organizational culture identifiers of the operational internal audit section when it existed separately, and the Subject auditor following devolution are:

Clan: 23

Adhocracy: 9

Market: 24

Hierarchy: 40

Thus, the plot for the culture of the operational internal auditors as a group follows (this culture did not change within the group even after the group were subsumed into line management – once an auditor always an auditor.):

Figure 6.1

This compares with Subject 1's view of the organization as a whole.

6.1.1.2 Subject 1's view of Organizational Culture of the Whole Organization

The values for the organizational culture identifiers for the organization as a whole selected by him were:

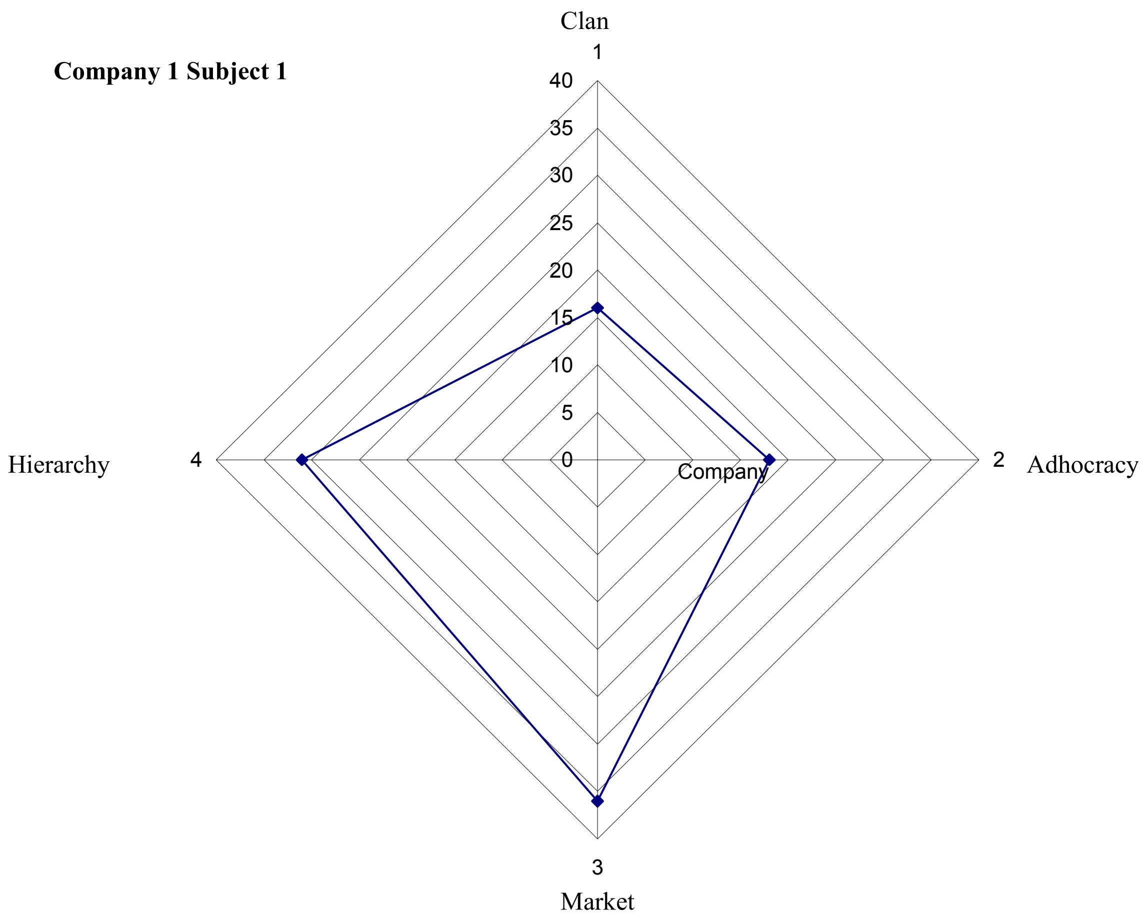
Clan: 16

Adhocracy: 18

Market: 36

Hierarchy: 31

Figure 6.2



Thus while the organization as a whole is a market driven hierarchy/bureaucracy, the first figure indicates that the operational internal audit section is quite different. While they have only a relatively slight interest in the market, they are more clannish than market driven. Further they have very little interest in adhocracy, and are very strongly hierarchical/bureaucratic.

If one makes the usual assumption that auditors are interested in “following the rules”, this is a logical outcome. It would therefore appear that even though the nature of the audit may be non financial, operational internal auditors are more interested in hierarchical controls than the rest of the organization they form part of. In this way they reflect the same expected values as all auditors. Further they recognize the different cultural value set that the organization may hold as against their own cultural value set. The question now is does this flow through directly to the activities of audit and management and how they interplay.

6.1.1.3 Subject 1’s View of the Role of Internal Audit within Organization 1

Using the score:

Strongly agree = 7 to Strongly disagree=1 Part C was answered as follows:

Question 1. The Operational Internal audit Process is planned in conjunction with both senior management/board and line management involvement?

Subject 1 selected a value of 6 for this question.

The Subject indicated that the line managers and senior managers were both involved in the management of the operational audit. Unfortunately the distinction between line management and operational internal auditor in this area is blurred by the fact that the persons responsible for the audit activity were also required to undertake line activities so as to maintain their skill levels at a point where they could effectively observe others and see if they were functioning at the required skill level. Also the auditing function was overlapped with the training function. While the overlap was not complete it was significant. This is a normal situation for this industry. The culture of the organization, and the government regulation places the operational internal audit person in a position of considerable authority, with the training person one step below. The operational internal audit person is also entitled to (and often actually does) the training. While this overlap may seem to be inappropriate, it is accepted within the industry, as the pressures on the trainee are such that this approach is considered to lead to less stressful training, and thus help the trainee to cope with what are very stressful training and testing activities.

Question 2. All risks are properly identified and include in the audit process?

Subject 1 gave a value of 6 for this question

Subject 1 considered that the organization has managed to identify most (but not all) risks. It is considered that top management see one set of risks as the key risks the organization faces, however they do not understand the technical complexity of these risks. Thus, management of the risk is delegated within the organization in an ad hoc fashion. The weakness of this delegation is highlighted by at least one other outside party with the comment:

"Management personnel reported that the (line) operations did not have any formal procedures for conduction risk assessments or identifying hazards to existing operations or new procedures. They indicated that risk assessment was a "new science" to them and they only became aware of it (recently). They believed that despite the lack of formal processes, their branch had effective processes in place for assessing the safety impact of issues, particularly with respect to the development of new procedures." (source withheld to protect confidentiality).

While the organization's management and Subject 1 were in agreement that the senior management of the organization could identify most risks, it appears that little thought existed as to how this would occur. In fact Subject 1 had considered for some time that the greatest risk was that a highly trained individual could have a lapse of judgment. While, recently, other risks have tended to dominate management's calculations of what constitutes the critical risks faced by the organization. This miscalculation of what remains in Subject 1's view the greatest risk, is considered by Subject 1 to be the greatest danger to the organization. As a result, Subject 1 and other operational auditors are constantly looking for acts that indicate poor judgment.

Question 3 The risk identification process is undertaken at a sufficiently high level within the organization.

Subject 1 scored this question with a ranking of 7

In Subject 1's opinion the organization spent a considerable amount of time assessing the risks that the business faced. This included financial risks, which were identified and monitored at a very high level, and closely followed by the Board. On the other hand, due to the technical nature of the operations, the identification of and monitoring of operational risks was delegated down several layers in the hierarchy of management. It was considered that the higher levels of management, and the Board, were not capable of following these activities in close detail. In fact, the failures within the government body responsible for oversight, outlined earlier, had created a situation where, while relying on the licence delivered by the government body, the government body was not considered to have sufficient technical understanding to follow the operations of the organization. While they feared the power of the government body, it was held in mild contempt. This was reinforced by a series of unfortunate incidents involving the government body's own operations, during the period when it was being restructured by legislation. These incidents reflected the slow deskilling of the government body that a combination of the restructure legislation and other factors had caused.

Question 4 Operational internal audit is independent of day to day management operations.

Subject 1 also scored this question with a ranking of 6.

In Subject 1's opinion, while the operational internal audit was often used by management to assist with the running of day-to-day operations, the nature of the appointment, particularly the government sanction, meant that the operational internal auditor had a significant level of independence. The level was not sufficient for Subject 1 to consider that the internal auditor was totally independent, but a level of independence existed. The fact was that the operational internal auditors were responsible for ensuring the procedural accuracy of everyone in that operational section of the organization that they audited, including each other. The routine nature of the audits, and the checks and balances created by the organization's internal audit being responsible to the government authority responsible for this type of transport, gave the internal auditors a degree of independence that they would not have normally had if they were just reporting to senior line management. Thus, the choice of a 6 indicating a positive level of independence was made. It is considered that this level of independence would not have been possible if the operational internal audit team only reported to line management.

Question 5. The operational internal auditor is sufficiently senior.

Subject 1 chose a 6 for this question.

Subject 1 considered the seniority level of the operational auditors sufficient to carry out their tasks. They certainly were more senior than the ordinary line managers and operators. The selection process of appointing them from within line management, and the fact that this represented both a promotion as perceived by their peers and also a genuine financial promotion caused them to be held in a certain amount of respect by the line managers they audited. They also wielded significant power. An adverse audit would result in the Subject manager having to undertake significant extra activity in the form of retraining to avoid demotion. The disadvantage from an audit perspective of being involved in line operations was largely overcome by the power they wielded. This resulted in the line managers treating them with significant deference. With power came responsibility, however, and at least in Subject 1's case, he worked hard to act as an impartial judge. In the back of his mind, however, was the knowledge that an inappropriate act by a line manager (even a relatively small act taken at a critical moment of judgment) could do severe damage to the organization and its reputation.

Thus, despite the lack of a formal reporting line up the hierarchy of the organization, Subject 1's opinion that the operational internal auditors were very close to being of sufficient rank may be considered justified.

Question 6 There is a proper quality control procedure in place within the operational internal audit function

Question six was designed to discover if the operational internal audit department had effective controls in place that would in the view of the Subject keep the operational internal auditors properly managing their role.

The Subject also selected a 6 for this question. Subject 1 considered that the oversight of the regulatory authority was sufficient to cause the internal auditors to function effectively regardless of the existence or otherwise of a structured department.

Question 7 The operational internal audit function is recognised as important to the organization in that it adds value to the organisation

A 6 was chosen for this question, too.

Question 7 was designed to discover the general organizational attitude to the operational audit function. From the ranking, it could be seen that the operational internal audit function is held in reasonably high regard within the organization. This is to be expected as the method of choosing the operational internal auditors from the better performing members of the line management operation causes these people to be seen by themselves as the best within the organization.

Question 8 The Organization has procedures to deal with ethical problems.

Question 8 was designed to see if persons within the organization considered that it had processes in place to handle ethical issues. Subject 1 was of the strong opinion that it did. As far as Subject 1 was concerned, the organization had to be honest with itself in order to operate safely, thus the systems in place designed to make certain that it did operate safely contributed to its proper ethical behaviour. Subject 1 saw these systems as strong and robust. Thus a 6 was selected here.

Question 9 The operational internal audit function is involved in the management of ethical problems.

This question was designed to examine the method of delegation of ethical problems within the organization. In fact the delegation of decision making on ethical matters was considered to be managed similarly to operational matters. Operational ethical matters was seen by Subject one as being handled within the operational section, at least as far as day-to-day operations concerned. This management of day-to-day ethical issues within the core operations of the organization led to the view that processes existed to solve ethical issues. As a result a 6 was selected for this question.

Question 10 The planning and procedures of the operational internal audit function conform with the professional standards.

While Subject 1 saw the operational internal audit section as well managed, he considered that the organization as a whole was convinced that its own methods were the best, and as a result did not often look outside the organization. He felt that this tended to cause the operational internal audit section of the organization to be very conservative in its ways and therefore often to lag behind in adopting improvements, so a five was selected for this question

Question 11 . The risks the business faces, and operational internal audit procedures are reviewed regularly to ensure that the organization does not face unidentified risks.

For the same reasons as led to a lagging behind in the adopting of new developments, the Subject considered that the reviewing of procedures by the operational internal audit department tended to be ad hoc, and thus while most risks were identified and met, there was no determined approach to recognize new risks, thus it was considered that unidentified risks could lie dormant, until an event caused them to crystallize. For this reason a near middle of the road position of a five was chosen.

Question 12 The operational internal audit function is cost effective to the organization.

Partly because of the failure to identify changing risks, and partly because the organization had not developed a formal way to measure the contribution of the operational internal audit, the operational internal audit existing as much as a result of regulatory requirements as organizational desire, the Subject was neutral on the question of cost effectiveness of the operational internal audit to the organization, choosing a four.

Question 13 The operational internal audit function is involved in the design of the financial internal controls.

Subject 1 chose not to answer this question. Within his organization, he sees the operational internal audit as having no input as far as direct financial controls are concerned. Accordingly he considered the question to be not applicable. Subject 1 then elaborated that had he answered it he would have chosen a 1.

Question 14 The operational internal audit function is involved in the design of the non financial internal controls.

On the other hand, the operational internal audit, while not the final arbiter of the non-financial internal controls, has a major and important input into the design of these controls, as they apply to the operational area, accordingly Subject 1 chose a six. This is a true reflection of the role of the operational internal audit in the design of the internal control system within this organization. In this regard, Subject 1 had been intimately involved in the design of operational controls. The basic operational internal control procedures were designed by the equipment manufacturers, but the operational internal audit was involved in “fine tuning” these systems and procedures, and also giving the manufacturer feedback where necessary. Such feedback assisted the manufacturer in maintaining and improving the operating procedures that were recommended to users.

Question 15 Control self assessment is used regularly in designing the internal controls

To the extent that the operational internal auditors were intricately involved in operational activities themselves, and accepted recommendations from management for improvements to systems, the concepts of control self assessment could be considered to apply. Thus Subject 1 selected a 5 for this question. It should be noted here that when operational internal auditors undertook practical activities to maintain their skill levels they subjected themselves to a peer audit.

Question 16 All the internal controls are documented in procedures manuals.

Subject 1 considered that operational documents were complete and concise and the controls written into them were practical and therefore there was no excuse for line managers not to follow these instruction manuals. He therefore gave the question a ranking of 7.

Question 17 All internal control procedures are always followed.

Even though he considered that operational documents were practical, the Subject stated that from experience, he found that, on occasion, managers deviated from set procedures. This led him to select a 5 for his response.

Question 18 Effective undocumented internal controls exist within the organisation.

Strong peer pressure exists between managers, to maintain documented procedures. The Subject interpreted this as a form of undocumented internal control. For this reason the Subject selected a relatively high 5 for this answer despite picking a perfect 7 for question 16.

Question 19 Undocumented controls are at least as important as documented controls.

Subject 1 considered the peer pressure amongst line managers to maintain documented internal controls to be as important in the overall success of the control system almost as important as the fact that there are complete and strong documented internal control system.

Question 20 Staff involved in carrying out processes are involved in the design of controls over those processes.

This question was designed to test the answer to question 15. Question 15 used professional jargon, question 20 stated the same situation in plain language. The Subject readily recognized the involvement of the line managers and also the operational internal auditors, who often acted as normal line managers to keep themselves up to date. In the determining the internal control structure. He, therefore, was willing to recognize this by ranking this question with a 5, slightly higher than question 15. It should be noted that the Subject often immersed himself in operational activities, and considered that an operational internal auditor who did not would soon loose touch with the operational side, and thus could find himself Subject to criticism from the auditees.

Question 21 The operational internal auditor has free access to the board or a board committee.

As noted, this question was designed to discover if the operational internal audit, which by its nature would have a significant effect on the profitability of the organization was able to directly access the board. The result surprisingly was an emphatic no. In any case, as far as the Subject was concerned the Board would not have the skill set to comprehend any operational problems that the organization may have.

Question 22 The operational internal auditor has assisted the organization to reduce the incident of loss through fraud.

Subject 1 considered that operational internal audit had a very limited involvement in direct financial review and therefore chose not to answer this question.

Question 23 The operational internal auditor has assisted the organization to reduce/avoid losses generally.

The Subject considered that the operational internal audit had been generally effective in particular in protecting the organization from losses. Accordingly the Subject selected a 6 for this option.

Question 24 All procedures are properly documented.

The Subject noted that while controls were generally well documented, overall documentation of procedures was not totally complete. This caused the Subject to select a 5 for this option.

Question 25 There is a strong degree of commonality of procedures across the organization.

The organization contained several operating divisions. While many controls were applied organization-wide, certain controls were division-specific, largely because of different processes and equipment.

6.1.2 Subject 2 of Organization 1

Subject 2 held an operational line management position within organization 1. As such he was in a position that may be audited by Subject 1. He had, however, never been audited by Subject 1. Subject two had been employed by the organization for slightly longer than 10 years. For persons in operational line management positions such as Subject one held, this length of service was not unusual.

6.1.2.1 Subject 2's view of Organization 1's Culture

Looking at Subject two's response to the cultural questions we find that the values are:

Clan: 9

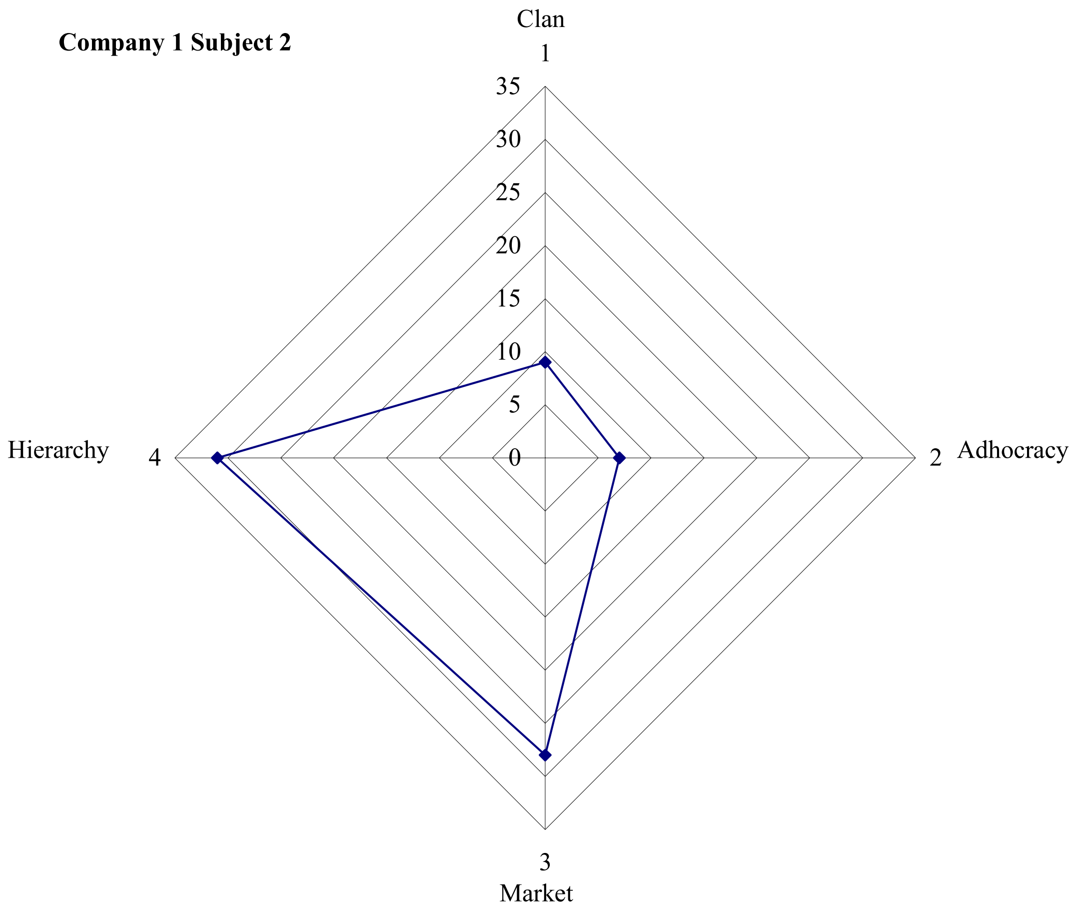
Adhocracy: 7

Market: 28

Hierarchy: 31

Thus, the culture of Organization 1 according to Subject 2 is set out in figure 6.3:

Figure 6.3



From figure 6.3, it can bee seen that the views of Subject 2 are consistent in both the direction and value of the culture of organization 1 with those of Subject 1, although starting from a lower base than Subject one. Thus while there is some difference between the two Subjects as to the strength with which the cultural values are held, the overall culture projected by the organization is recognized by both Subjects. This is in line with predictions by Cameron and Quinn (1999).

6.1.2.2 Subject 2's view of Organization 1's Use of Controls and Operational Audit

Subject 2 answered the questions designed to analyze the way operational internal audit is seen by the organization with the following values.

Question 1 The Operational Internal audit Process is planned in conjunction with both senior management/board and line management involvement

Subject 2 observed that in the design of the operational internal audit, both operational internal auditors and senior management were involved. In fact, the design of these programs also involved government and suppliers. He, therefore, chose to answer this question with a 6 which is identical to Subject 1's choice.

Question 2 All risks are properly identified and include in the audit process?

From Subject 2's point of view, management appears to have identified the main risks the organization faces. To some extent this is based on Subject 2's perception of what the main risks are. However, he was able to identify three risks that have had systems introduced that limit those risks or accurately quantify them. For this reason he selected a 6 for this question.

Question 3 The risk identification process is undertaken at a sufficiently high level within the organization.

Subject two’s selection of a 5 for this answer to some extent was an indication of his own level of seniority within management. While he realized that risk identification was managed at a reasonably high level, He considered that it was delegated to lower levels than perhaps appropriate, partly because he could see himself involved in risk identification and management at his level. He could also see that at the level of senior management and above, the intellectual ability to comprehend the technical aspects of risk identification was limited.

Question 4 Operational internal audit is independent of day to day management operations.

Question 4 was answered with a 6. The operational internal audit were seen by management working at the line level to be largely independent of the persons they were auditing, and to significantly outrank them within the organization. Thus while the operational internal audit may not be reporting much further up the hierarchy, they are seen by the management as having sufficient reporting skills. He also noted the strong orientation of operational internal audit towards procedures and rules. This reinforced the cultural outcome for the organization’s operational internal audit shown at Diagram 6.1.

Question 5 The operational internal auditor is sufficiently senior.

As mentioned in question 4, Subject 2 considered that the operational internal audit, while not “reporting all the way to the top” does in fact report to a reasonably high level in the organization. For this reason Subject 2 chose to respond to this question with a 6.

Question 6 There is a proper quality control procedure in place within the operational internal audit function

While Subject 2 dealt regularly with operational internal auditors, and from his own experience felt that the quality management of operational internal auditors, while good could be improved. There were instances to his knowledge, where quality control over operational internal auditors had broken down. For that reason he selected a 5 for this question. It is to be expected that he would be more critical of operational internal audit, which impinges on his day to day activities than the operational internal audit themselves, thus the fact that he selected a 5 and Subject 1 selected a 6 is not unexpected. That they are only separated by one point indicates that both have similar views on the question.

Question 7 The operational internal audit function is recognised as important to the organization in that it adds value to the organisation

Again, not being an operational internal auditor, Subject 2 did not put the same organizational importance on operational internal audit as the operational internal auditor himself. Again only separated by one point, with Subject 2 awarding a score of 5. Part of the reason behind Subject 2's view is that he considers that if the operational internal audit was removed, the organization would run successfully for some time without noticing their absence. This is not unexpected, given the highly professional nature of operational management.

Question 8 The Organization has procedures to deal with ethical problems.

Subject 2 disagreed strongly with Subject 1 as to the existence of procedures to deal with ethical problems. He felt that the organization was good at managing technical problems, but weak as far as ethical problems were concerned. In fact, he considered the processes in place barely workable, and accordingly answered this question with a 2.

Question 9 The operational internal audit function is involved in the management of ethical problems.

Subject two considered that the operational internal audit was principally interested in the management of technical problems, and he did not consider that members of the operational internal audit placed any weight on attempting to solve ethical issues. Accordingly he weighted this question with a 1.

Question 10 The planning and procedures of the operational internal audit function conform with the professional standards.

Subject two considered the operational internal auditor to behave in a very competent professional manner, and this extended to the way they planned their audit activities. He accordingly weighted this question with a 6.

Question 11 The risks the business faces, and operational internal audit procedures are reviewed regularly to ensure that the organization does not face unidentified risks.

Subject two considered that, at the senior level of the organization, there were few people capable of understanding the risks the organization faced. Accordingly he considered that many risks faced by the organization had not been identified by senior management, with the result that he allocated a 2 to this question.

Question 12 The operational internal audit function is cost effective to the organization.

Subject two's confidence in the operational internal audit was reflected in his view that generally the operational internal audit was cost effective. Thus he gave this question a ranking of 6.

Question 13 The operational internal audit function is involved in the design of the financial internal controls.

Subject two considered that the operational internal audit were not involved in considering the financial effect of the operational internal controls, and accordingly gave question 13 a rank of 1.

Question 14 The operational internal audit function is involved in the design of the non financial internal controls.

The operational internal audit was considered by Subject two to have considerable input into the non-financial internal controls. However Subject two realized that significant input came from other sources, both internal and external to the organization, including government, and even equipment manufacturers. For this reason he ranked this question with a 5.

Question 15 Control self assessment is used regularly in designing the internal controls

Because of the nature of the range of people and organizations who have input into the internal controls, Subject 2 did not consider that he as the manager who directly managed the operation had any significant input into the control system. For this reason he ranked this question with a 1.

Question 16 All the internal controls are documented in procedures manuals.

While he considered that the documentation of internal controls and procedures was extensive, Subject 2 considered that the variations in operational conditions were so great that the direct control by managers was the most effective system control. For this reason, he considered that an unwritten internal control system ran in parallel to the documented internal control system. He thus ranked this question with a 3.

Question 17 All internal control procedures are always followed.

Subject 2 considered that control procedures were often not regarded as sacrosanct and as a result, many internal control procedures were honoured in the breach. As a result of his views, he was unwilling to accept that control procedures were always followed. However, he considered that many controls were ignored at the peril of the manager concerned, and that accordingly he ranked this question with a 4.

Question 18 Effective undocumented internal controls exist within the organisation.

While feeling that undocumented internal controls existed, Subject 2 was of the view that these undocumented internal controls were rarely as effective as the documented internal controls, for this reason he chose a 2 for this question.

Question 19 Undocumented controls are at least as important as documented controls.

For the same reason, Subject 2 considered undocumented internal controls to be significantly less important that documented internal controls. He therefore selected a two for this question.

Question 20 Staff involved in carrying out processes are involved in the design of controls over those processes.

This test of interpretation of the meaning of control self assessment as set out in question 15 was dealt with consistently. Subject two again selected a 1.

Question 21 The operational internal auditor has free access to the board or a board committee.

Subject two chose not to answer this question as he was not certain of the reporting constraints on the senior operational internal auditors. Certainly he said that from discussions with junior operational internal auditors, he considered junior operational internal auditors to have little or no board access.

Questions 22 The operational internal auditor has assisted the organization to reduce the incident of loss through fraud, and 23 The operational internal auditor has assisted the organization to reduce/avoid losses generally.

Subject two had no opinion on the ability of operational internal auditors to reduce losses to the company financially or generally. Thus he chose not to select answers for these questions.

Question 24 All procedures are properly documented.

In line with his view about controls, Subject two considered that the documentation of operational procedures was incomplete. For this reason he selected a 2 for the answer to this question.

Question 25 There is a strong degree of commonality of procedures across the organization.

Subject two considered that the different operations within the organization lacked commonality of procedure. This is contrary to Subject one's view, and shows an interesting perception of differences. Subject one, deeply involved in several areas of the operation, considered that while there were differences, they were not as significant as Subject two, who viewed other areas of the operation of the organization from the position of an outsider, held. Subject two selected a 3.

6.2 Organization 2

Organization 2 was a direct competitor of Organization 1 but based in a different state. It was a larger organization, but both organizations were in employee numbers, capitalization, and other factors in the same order of magnitude.

6.2.1 Organization 2 Subject 1.

Subject 1 for Organization 2 was employed in a similar role to Subject 1 of Organization1. His duties consisted of auditing operational line management activities to confirm that they satisfied the organizations and the government's requirements. The legal rules surrounding Organization 2 are basically the same as that faced by Organization 1, however, the fact that each is based in a different state, results in some minor differences, which do not alter the basic role the two subjects within Organization 2. Like Subject 1 for Organization 1, this subject had also worked for an organization in the same industry for several years before commencing work for Organization 2. He had, however, moved to Organization 2 as a result of a decision to seek better employment rather than a result of a takeover or merger.

The different states took different approaches to the management of the licencing of the respective auditors. As a result the regulatory authority of the state in which Organization 2 was based had a far more close relationship with that organization than the corresponding relationship between Organization 1 and the state regulators where it was based. This altered the internal balance of power within Organization 2 as against Organization 1. In Organization 1 the internal operational auditor had significantly more power than the internal Operational auditor in organization 2.

Organization 2 had far more rigid management practices than organization 1. Both Subjects within Organization 2 considered the management practices of the organization to be combative – management v workers rather than conciliatory. In this regard, Subject 1 intimated that the organizational glue was more "fear" rather than the options put forward in the survey. On occasion this led to the principal external stakeholders appointing external representatives to negotiate directly with employees over operational conditions.

6.2.1.1 Subject 1's Questionnaire Responses about the Operational Internal Audit Culture of Organization 2

Subject 1 in Organization 2 had a quite different view of the role of the operational internal auditor to that held by Subject one in Organization 1. This is shown in his weighting of the internal operational audit section's values:

Clan: 34

Adhocracy: 25

Market: 30

Hierarchy: 34

Diagrammatically this is shown in Figure 6.4

Figure 6.4

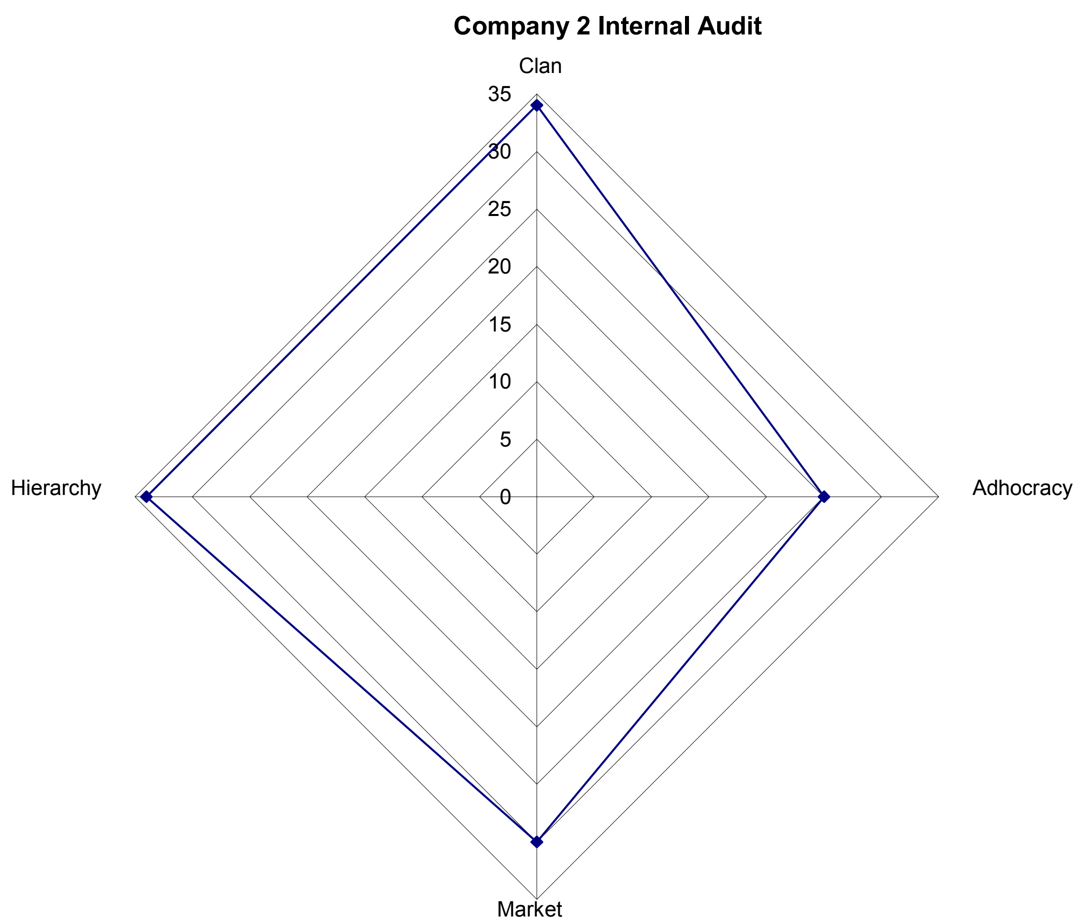


Figure 6.4 shows significant differences to the position of the operational internal audit section of Organization 1. In organization 1, the culture of the operational internal audit is strongly hierarchical or bureaucratic. In Organization 2's operational internal audit the culture is very mixed, while less of an adhocracy than a bureaucracy, the organization's internal audit is not strongly committed to bureaucracy/hierarchy as against adhocracy. In

fact looking at the organizational values as a whole, with clannish values being as important as hierarchy values, the operational internal audit would appear to be a feel good clannish hierarchy where because of the importance of the market, operations in which ad hoc activities occur would be more acceptable than in Organization 1. It is almost a case of an organizational operational unit (in this case the operational internal audit) trying to be “all things to all men”.

6.2.1.2 Subject 1 of Organization 2’s view of the Organizational Culture of the Whole of the Organization

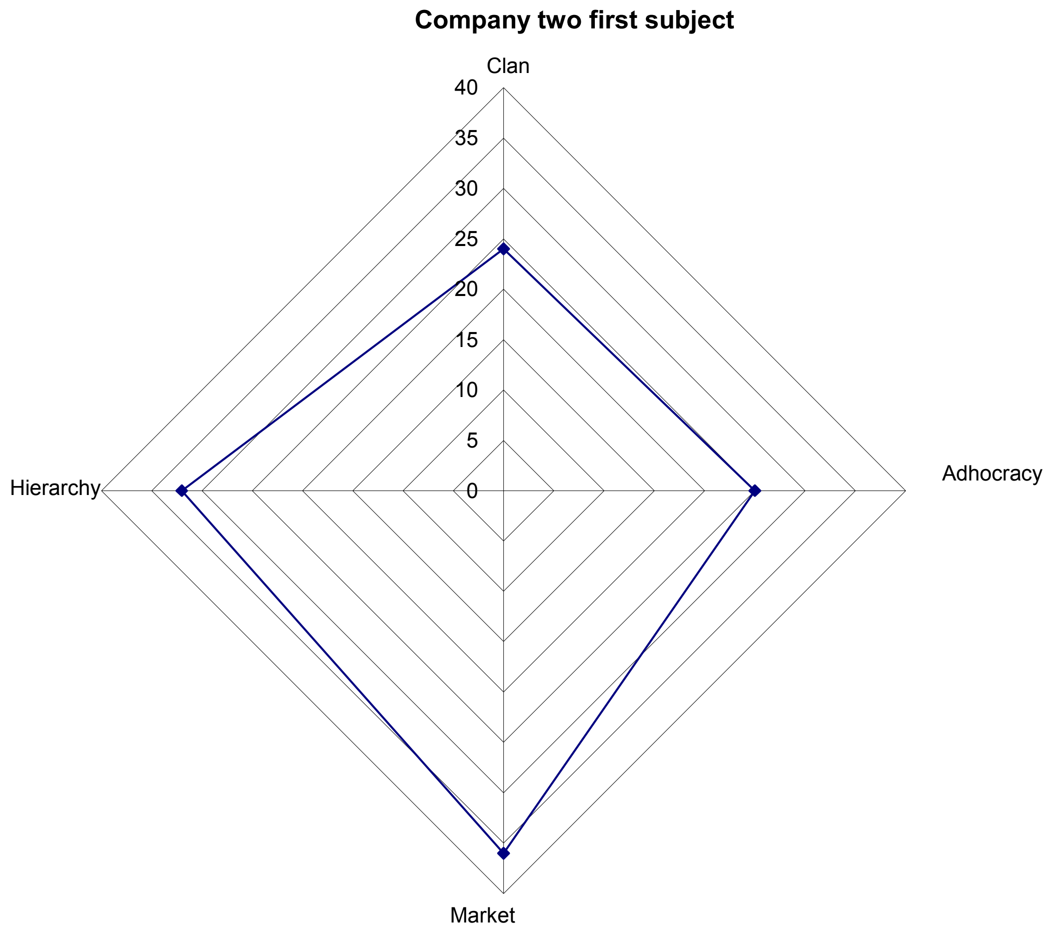
Subject 1’s view of Organization 2 as a whole is set out as:

Clan:	24
Adhocracy:	25
Market:	36
Hierarchy:	32

Which is represented diagrammatically in Figure 6.5.

Subject 1 sees the organization as a whole to be a market driven hierarchy. If the organizational culture is consistent then this view of the organization will also be maintained by Subject 2, however, Subject 2 has a completely different view of the organizational culture of Organization 2.

Figure 6.5



6.2.1.3 Subject 1's View of the Role of Internal Audit within Organization 2

Analyzing the approach to operational activities of Organization 2 to internal audit and internal control, Subject one made the following choices.

Question 1 The Operational Internal audit Process is planned in conjunction with both senior management/board and line management involvement

Subject 1 considered that the Board did not get involved in planning the operational internal audit process other than briefly confirming that it met statutory requirements. He rarely saw any of the Board at the operational level, and did not consider that they were significantly involved. They did, however, express some interest, especially following catastrophes. Accordingly, Subject 1 gave this question a ranking of 5.

Question 2 All risks are properly identified and include in the audit process?

Subject 1 considered that the majority of risks was properly identified, but the organization required further research of itself and its operations before he was confident that all significant risks were identified. A contributing factor to Subject 1's view of this topic was his opinion that the risks the organization faced were not static. He chose a 5 for this question as a result.

Question 3 The risk identification process is undertaken at a sufficiently high level within the organization.

Subject 1 considered that the level of management that was responsible for managing operational risks within Organization 2 was sufficient for the purposes of protecting the organization from most risks, in that at that level most risks could be identified and understood. He did however consider that risk management could be improved if the higher levels of management were more deeply involved. He, therefore, chose a 5 for this question.

Question 4 Operational internal audit is independent of day to day management operations.

To a large extent, while involved in day-to-day management, the operational auditors of Organization 2 were sufficiently independent to be able to assert themselves with regard to any matter that they considered important. For this reason Subject 1 chose a 6 for this question.

Question 5 The operational internal auditor is sufficiently senior.

Subject 1 considered the seniority of the operational internal audit to be such that t could generally maintain adequate independence in carrying out its duties. For this reason Subject 1 chose a 6 for this question.

Question 6 There is a proper quality control procedure in place within the operational internal audit function

Subject 1 considered that the operational internal audit was properly managed and that the quality of the operational internal audit conformed with international standards. He took the position, however, that there was always the possibility of improvement, and accordingly he ranked the question with a 6.

Question 7 The operational internal audit function is recognised as important to the organization in that it adds value to the organisation

Because of the nature by which the operational internal auditors were selected by the senior members of the operational internal audit department, from the most experienced and competent line managers, the appointment was considered to hold a high level of prestige. This resulted in Subject 2 selecting a 2 for this question.

Question 8 The Organization has procedures to deal with ethical problems.

Organization 2 prided itself on its ability to handle ethical issues among its employees who came from diverse backgrounds. As a result, Subject 1 considered that the organization had excellent procedures for managing ethical problems. He, therefore, gave this question a score of 7.

Question 9 The operational internal audit function is involved in the management of ethical problems.

The management of ethical problems within Organization 2 was through its human resources operation, and while the operational internal audit had a role in identifying any problems, it was not directly involved in the management of the problems, accordingly Subject 1 awarded a 3 for this question.

Question 10 The planning and procedures of the operational internal audit function conform with the professional standards.

While Subject 1 considered that there was room for improvement, he considered that the planning and procedures of the operational internal audit department conformed to international professional standards. He, therefore, chose a 6 for this question.

Question 11 . The risks the business faces, and operational internal audit procedures are reviewed regularly to ensure that the organization does not face unidentified risks.

Again, while he considered the risk management processes of the organization to be very good, and the chances of failing to identify a risk low, Subject 1 considered that there was some room for improvement, and for that reason gave this question a score of 6.

Question 12 The operational internal audit function is cost effective to the organization.

Subject 1 considered that the operational internal audit existed to assist line management in providing guidance in the management of day to day operations. In his view the way it was run within Organization 2 allowed for considerable "organizational slack". Thus he selected a 5 for this question.

Question 13 The operational internal audit function is involved in the design of the financial internal controls.

Subject 1 considered that while the operational internal audit had significant input into the design of the internal controls that may influence financial aspects of the operation, there are others both within and without the company, including the government department responsible for regulation of the industry, and equipment suppliers who also have much input. Thus Subject 1 selected a 5 for this question. Subject 1 took a broad view of internal controls that considered that any activity of the organization had an influence on the finances of the organization, and thus did not differentiate conceptually between financial and non-financial controls

Question 14 The operational internal audit function is involved in the design of the non financial internal controls.

The main responsibility of the operational internal audit was seen as being the management of the operational internal controls, however as explained in question 13, Subject 1 considered that the government department responsible for oversight of the organization, as well as equipment suppliers and other areas within the organization were also involved in the design of operational internal controls. Thus Subject 1 remained consistent and selected a 5 for this question.

Question 15 Control self assessment is used regularly in designing the internal controls.

Subject 1 considered that only certain levels of management of the organization were involved in control self assessment. He, therefore, chose a 5 for this question.

Question 16 All the internal controls are documented in procedures manuals.

Subject 1 considered the operational documents which Organization 2 used to manage and control all its operations were complete. He did, however, consider that they were not perfect. As a result he selected a 6 for this question.

Question 17 All internal control procedures are always followed.

Subject 1 believed that the internal controls were being generally followed within Organization 2, and, therefore, ranked this question with a 5.

Question 18 Effective undocumented internal controls exist within the organisation.

When it came to undocumented controls, Subject one considered that such undocumented controls as peer pressure not to deviate from documented controls did exist, however, these controlling influences were not as strong as he believed they should be and were partially countered by peer pressure to be seen to be performing. On this basis, he chose a 5 for this question.

Question 19 Undocumented controls are at least as important as documented controls.

Subject 1 felt that the results of attitudes set out in question 18 weakened the ability of undocumented internal controls to function effectively to the extent he expressed in question 18, and so chose a 5 again.

Question 20 Staff involved in carrying out processes are involved in the design of controls over those processes.

Despite having chosen a 5 at question 15, when it came to this question, Subject one chose a 4. This was driven by his interpretation of question 15 which recognized the input of the operational internal auditor in the design of controls. In this question he considered only the role of line management. In his view, line management (and those below them) played a more restrictive role in the design of internal controls. He did, however, continue to recognize that they had some input. For this reason he selected a 4 for this question.

Question 21 The operational internal auditor has free access to the board or a board committee.

The process by which the operational internal audit undertook its role within the organization resulted in a limited right of access to the board of the company by the most senior member of the operational internal audit. In recognizing that right, Subject 1 gave this question a score of 6.

Question 22 The operational internal auditor has assisted the organization to reduce the incident of loss through fraud.

Subject 1 considered that aspect of the operational internal auditor's role prevented certain financially improper acts against the organization, and because of these operational aspects he gave this question a 6.

Question 23 The operational internal auditor has assisted the organization to reduce/avoid losses generally.

Subject 1 considered all sources of loss here including operational mistake, which in his view could create a huge loss situation of the organization. He considered that operational internal audit significantly reduced the exposure to loss that the organization faced, so he chose a 6 for this question

Question 24 All procedures are properly documented.

Subject one considered that the organization was strong on documenting procedures and processes. He did however recognize that some internal controls existed that were more social in nature, and this led him to avoid taking an absolute position with this question. He chose a 6.

Question 25 There is a strong degree of commonality of procedures across the organization.

Subject 1 considered that what he considered core procedures existed across the organization, however operational differences did exist in certain areas. He did not consider those differences sufficient to result in a ranking of less than 5 for this question.

6..2.2 Subject 2 of Organization 2

Subject two was employed in a similar line management role to Subject 2 with Organization 1, and had faced the same audit processes. Subject 2 had been employed by Organization 2 for a similar period to the period Subject two in organization 1 had been employed by Organization 1.

6.2.2.1 Subject 2's view of Organization 2's Culture

Subject 2 of organization 2 set the following values of his view of the organization as a whole:

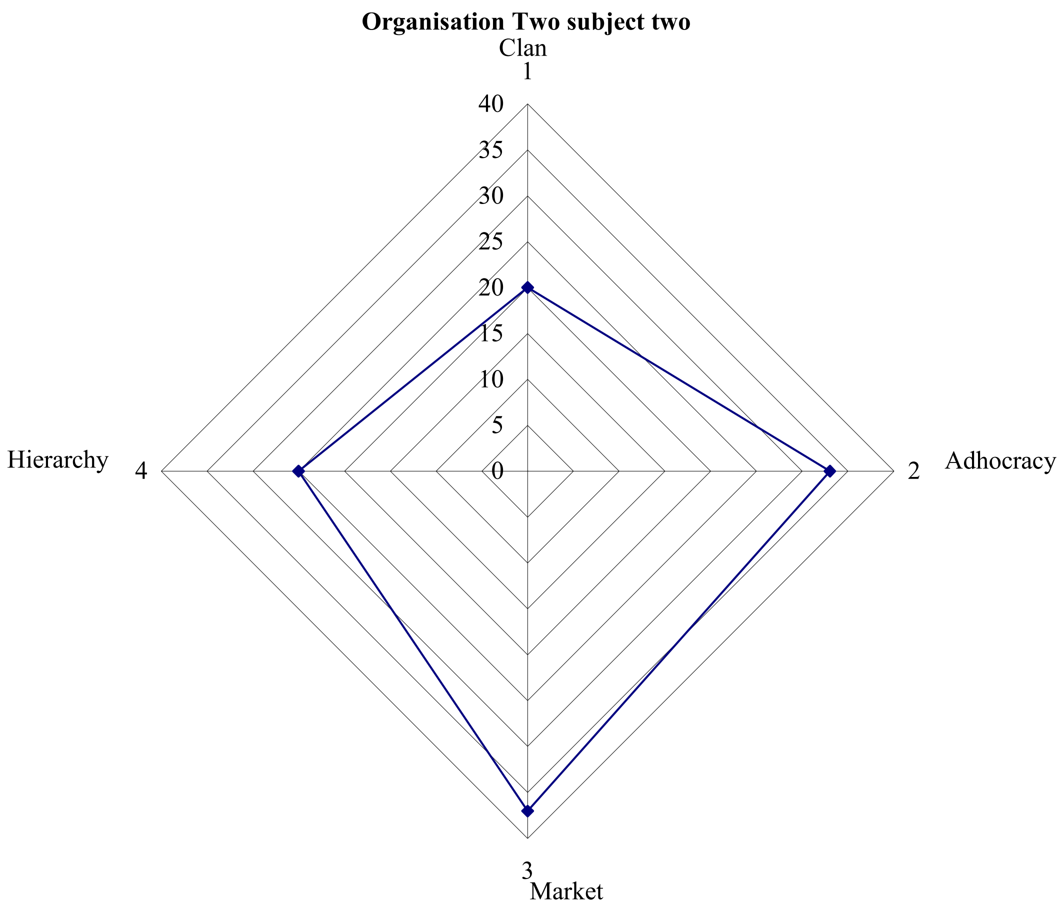
Clan: 20

Adhocracy: 33

Market: 37

Hierarchy: 25: This gives a culture diagram as shown in figure 6.6

Figure 6.6



Thus from the point of view of the line manager in Organization 2, Organization 2 is a market driven adhocracy. This is not in line with the view of the operational internal auditor in Organization 2, who sees the organization as a market driven hierarchy, more closely comparable to the views that both Subjects in Organization 1 hold of Organization 1.

6.2.2.2 Subject 2's View of the Role of Internal Audit within Organization 2

Question 1 The Operational Internal audit Process is planned in conjunction with both senior management/board and line management involvement

Subject 2 considered that line management was involved in the design of internal audit, however they had no overriding authority, and many other interested parties provided input including government, senior management and the equipment manufacturers. He, therefore, selected a 5 for this question.

Question 2 All risks are properly identified and include in the audit process?

Subject 2 considered that the majority of risks were identified, and as a result included in the line audit process, he did, however, consider that the organization had not reached perfection in identifying the risks it faced, and accordingly awarded a 6 for this question.

Question 3 The risk identification process is undertaken at a sufficiently high level within the organization.

Subject 2 considered that part of the reason that he chose a 6 (and not a 7) for question 2 was the fact that senior management within the organization were not able to understand the nature of some of the risks that could, if not properly controlled, lead to some spectacular outcomes. For this reason he selected a 3 for this question.

Question 4 Operational internal audit is independent of day to day management operations.

While Subject 2 considered the operational audit to have significant skills and abilities that enabled them to perform their function successfully, he did feel that they were involved in day to day management simply by the way they carried out their role within the organization. He, therefore, selected a 5 for this question.

Question 5 The operational internal auditor is sufficiently senior.

While, in his view, the operational internal auditor was adequately senior within the organization, Subject two was of the view that senior management could adversely affect the independent decisions and guidance provided by the operational internal auditor. He considered this significant disadvantage to the organization given the lack of understanding of certain operational risks by senior management. For this reason he chose a 5 for this question. In short, he felt that the operational internal auditor should be more senior.

Question 6 There is a proper quality control procedure in place within the operational internal audit function

Being an outside observer of the operational internal audit, Subject two had seen a wide variety of operational internal auditors, and come to the conclusion that the good were very very good and the bad very very bad. He considered that the bad slightly outweighed the good. As a result he chose a 3 for this question.

Question 7 The operational internal audit function is recognised as important to the organization in that it adds value to the organisation

Subject 2 considered that within the organization, the operational internal audit was considered to be well respected, but not considered sufficiently outstanding to be scored above a 5.

Question 8 The Organization has procedures to deal with ethical problems.

Subject 2 considered the processes in place within Organization 2 to handle ethical issues while they existed, were inadequate he thus awarded this question a 3. In responding to this question, and the next, Subject 2 made it clear that lack of trust was a major factor within the organization.

Question 9 The operational internal audit function is involved in the management of ethical problems.

While the operational internal audit was involved in the management of ethical problems within the organization, the lack of trust caused line managers to be very wary of both the operational internal audit, and senior management when it came to full and frank disclosure in this area. The result was that the system was seen as inadequate and awarded a 3, recognizing that it did exist.

Question 10 The planning and procedures of the operational internal audit function conform with the professional standards.

From his external perspective, and with considerable experience across a number of similar organizations before commencing with Organization 2, Subject 2 considered that, in particular, the procedures carried out by the operational internal audit were not industry best practice. In fact, he chose to score this question with a 2, indicating that he considered the processes inadequate.

Question 11 . The risks the business faces, and operational internal audit procedures are reviewed regularly to ensure that the organization does not face unidentified risks.

Similarly, Subject 2 considered that few within the organization indicated to him that they understood the true nature of the key risks the organization faced. The fact that, in his view, several risk situations had been badly mishandled, vindicated his scoring this question with a 2.

Question 12 The operational internal audit function is cost effective to the organization.

While he was critical of the operational internal audit function, Subject 2 did consider it to be passably cost effective, and scored this question with a 5.

Question 13 The operational internal audit function is involved in the design of the financial internal controls.

Subject 2 recognized that the operational internal audit did play a significant but not absolute part in the design of internal controls. He considered all internal controls to have a financial perspective. However, he recognized the input of others within the organization, the government administrative agency, and the equipment manufacturers. He chose a 5 for this question.

Question 14 The operational internal audit function is involved in the design of the non financial internal controls.

Subject 2 considered question 14 to be very similar in meaning to question 13 because of his view of the fact that any activity had a financial effect on the organization. As a result he chose a 5 for this question also.

Question 15 Control self assessment is used regularly in designing the internal controls.

Subject 2 did not consider that as a line manager he had a very significant role in creating the controls under which he worked. He did, however, recognize that he was in a position to make suggestions, and as a result had some input. He chose a 3 to reflect this fact.

Question 16 All the internal controls are documented in procedures manuals.

Subject 2 considered there were a number of important internal controls that had avoided documentation. He accordingly selected a 2 for this question.

Question 17 All internal control procedures are always followed.

While he considered that generally internal controls were followed, Subject two also took the view that they were not always followed, to reflect this situation, he chose a 3.

Question 18 Effective undocumented internal controls exist within the organization.

Recognizing that a number of undocumented internal controls existed, Subject 2 also considered that these were not large in number, and therefore decided that, as virtually all key controls were documented, he should select a 3 for this question.

Question 19 Undocumented controls are at least as important as documented controls.

Subject 2 considered that one or two key controls had not been documented, and probably could not because they would involve going against international standards. They were, however, fairly important, and for that reason he chose a 6 for this question.

Question 20 Staff involved in carrying out processes are involved in the design of controls over those processes.

This is of course question 15 without the jargon, and was given the same score of 3 by Subject 2, thus recognizing that he was consistent in his approach.

Question 21 The operational internal auditor has free access to the board or a board committee.

Subject 2 considered that the operational internal audit was in a position to approach senior management up to and including the board of the organization if it was considered necessary. Subject 2 considered this not to be an everyday event, so chose to score this question with a 6.

Question 22 The operational internal auditor has assisted the organization to reduce the incident of loss through fraud.

While he recognized that all activities had a financial perspective, Subject 2 considered that the nature of the operational side of the organization was such that operational internal audit would have little chance to deal with fraud of any significance. For that reason he scored this question with a 2.

Question 23 The operational internal auditor has assisted the organization to reduce/avoid losses generally.

On the other hand the operational internal audit's activities to generally protect the organization from loss was not admired by Subject 2, and accordingly he awarded the operational internal audit a 3 for what was its principal aim.

Question 24 All procedures are properly documented.

Subject two answered this question in line with his views at question 16 about internal controls. He understood that successful internal controls are built into procedures. He did not consider the documentation system of the organization was geared towards practicality. For this reason he chose a 2 for this question.

Question 25 There is a strong degree of commonality of procedures across the organization.

Subject 2 considered that many parts of organization 2 operated independently without considering procedures or processes of other areas. He considered this to be a disadvantage to the organization, and scored this question with a 2.

6.3 Organization 3

Organization 3 is in exactly the same type of transport activities as organizations 1 and 2. It is, however, based in a third state. In terms of size it is of similar order of magnitude to the other two organizations investigated here. It is, though, the smallest of the three organizations.

It was originally a state-owned transport organization that restricted its operations to the state which owned it. It was privatized several years ago. The method of privatization was effectively similar to a management buy out. The result of this is that it continues to run as a quasi public sector operation. Prior to the privatization, the organization had acted as virtually its own government administrative department, effectively administering itself.

Since privatization, the organization has expanded its operations, and now operates across several states. Within its own state, however, the organization dominates its activities, and accordingly is the main operation being administered by the now separate government administration charged with overseeing its type of operations. When it was "hived off" as a private entity, many of the administrative skills went with it. Thus the government administration is significantly reliant on the organization to provide administrative guidance. As the government department gains experience, however, this reliance is diminishing.

When it entered into its period of expansion, the organization sought and obtained detailed technical assistance from several other organizations with strong technical knowledge, based in other states. It obtained assistance from one organization with wide technical experience in operating between states, that was not in direct competition with it, and was unlikely to be so in the future. It also obtained detailed technical support from organizations that were involved in providing equipment. Initially, the organization was totally reliant on these forms of support, but as its experience in operating between states has grown, so it has been able to develop its own expertise. As a result, it is slowly replacing the borrowed technical support with its own in-house technical support.

For that period when the organization was totally reliant on external technical support, its culture was considered by the organization's Subject 1 to be strongly influenced by the culture of the organization that was supplying its primary expertise.

The first move by the organization to become independent of the organizations supplying it with support was to head-hunt the two most senior and most competent persons in the operational side of the organization that had been providing it with technical support. This was successful, and for several years it enjoyed the fruits of its head-hunting activities. As these people have moved on, however, the organization has replaced them with internal appointments. While the internal appointments have been trained in the ways of the two outside appointees, they have a long history with the organization, having been immersed in its culture and traditions long before the imposition of the two outside appointees. It is considered that the organization is moving culturally away from the direction set when the two external appointees were controlling the organization.

6.3.1 Organization 3, Subject 1.

Subject one of Organization 3 has over thirty years experience within the type of organization investigated in this study. For several years he was a line manager with a similar organization based in another state. He then worked for a short period as a line manager for a similar organization based in a fourth state, that specialized in supplying support to other organizations, so that they could continue to operate.

He was employed by Organization 3 originally in a line management role. Following a period of ongoing training and experience, Subject one moved to an operational internal audit role within Organization 3 and it was in this role that he was interviewed and supplied detailed support.

6.3.1.1 Subject 1's Questionnaire Responses about Operational Internal Audit Culture

The values for the organizational culture identifiers of the operational internal audit section are:

Clan: 32

Adhocracy: 10

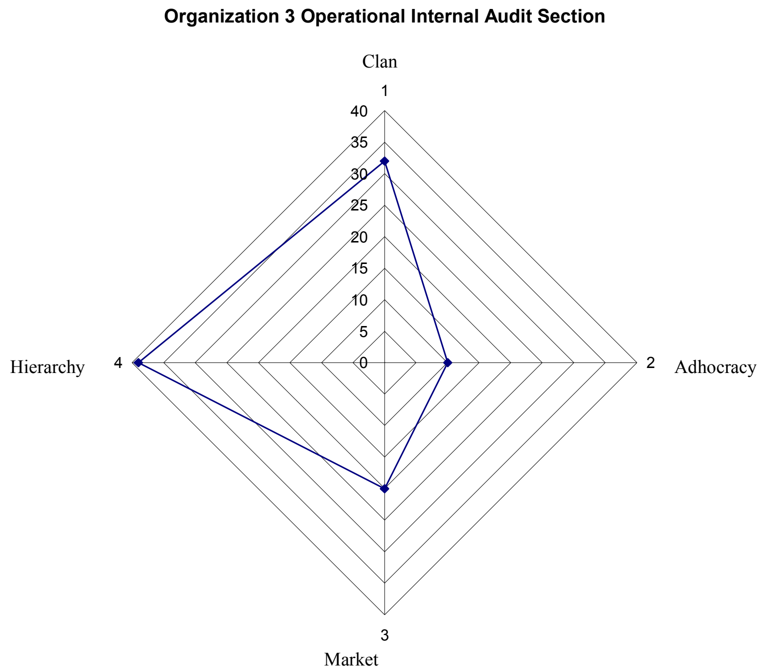
Market: 20

Hierarchy: 39

Thus, the plot for the culture of the operational internal auditors as a group is shown at Figure 6.7.

From Figure 6.7, Organization 3's internal operational audit is very strongly hierarchical, and noticeably clannish but hardly permissive of ad hoc activities. The similarity to the plot of the organizational culture for the internal audit section of Organization 1 is quite noticeable.

Figure 6.7



This compares with Organization 3 Subject 1's view of the organization as a whole:

6.3.1.2 Subject 1's view of Organizational Culture of the Whole Organization

The values for the organizational culture identifiers for the organization as a whole selected by him were:

Clan: 28,

Adhocracy: 7

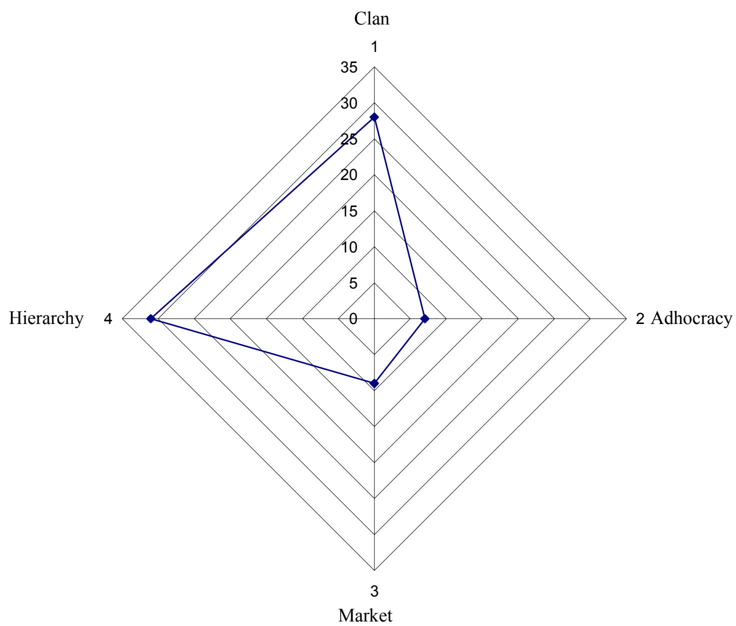
Market: 9

Hierarchy: 31

This was plotted on Figure 6.8

Figure 6.8

Organization 3 As a Whole from Operational Internal Audit Perspective



Thus, while the organization as a whole is a clan-based hierarchy/bureaucracy, the first figure indicates that the operational internal audit section is different in that it is less clannish, more conscious of the market, and holds bureaucratic values more strongly than the organization as a whole. In fact, the operational internal audit of the organization reveals a significant similarity to Organization 1's operational internal audit culture. The only difference is that Organization 3's operational internal audit is more clannish than Organization 1's operational internal audit.

While they have only a relatively slight interest in the market, the operational internal audit of Organization 3 has a greater interest in the market than Organization 3 as a whole. Further neither the organization as a whole or the operational internal audit shows significant interest in adhocracy, and both are very strongly hierarchical/bureaucratic. This is considered to be a cultural overhang from the days when the organization was a government department. In fact Subject one considered that both the strong clannishness and the strong bureaucratic style of the organization were both due to the organization having been a government department in the past, and the extent of influence that the government maintained over the organization at present.

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6.3.1.3 Subject 1's View of the Role of Internal Audit within Organization 3

Using the score:

Strongly agree = 7 to Strongly disagree=1 part C was answered as follows:

Question 1 The Operational Internal audit Process is planned in conjunction with both senior management/board and line management involvement

Subject 1 selected a value of 4 for this question.

The Subject indicated that the operational internal auditor was assigned on a routine rolling basis rather than being allocated to particular audits on a selective basis.

Question 2. All risks are properly identified and include in the audit process?

Subject 1 gave a value of 4 for this question

Subject 1 considered that the organization has managed to identify many (but not all) risks. It is considered that top management see one set of risks as the key risks the

Question 3 The risk identification process is undertaken at a sufficiently high level within the organization.

Subject 1 scored this question with a ranking of 4. Risk identification is not a strong point of the organization, it does not happen at a high level, but rather “at the coal face”, where many of the risks become obvious.

Question 4 Operational internal audit is independent of day to day management operations.

Subject 1 also scored this question with a ranking of 4. The nature of the operational internal audit is such that it works closely with the persons it is auditing. The result is that it is not strongly independent. This is reinforced by the clannish nature of the organization.

Question 5. The operational internal auditor is sufficiently senior.

Subject 1 chose a 3 for this question.

Subject 1 considered the seniority level of the operational auditors sufficient to carry out their tasks. They certainly were more senior than the ordinary line managers and operators. The selection process of appointing them from within line management, and the fact that this represented both a promotion as perceived by their peers and also a genuine financial promotion caused them to be held in a certain amount of respect by the line managers they audited. They also wielded significant power. An adverse audit would result in the Subject manager having to undertake significant extra activity in the form of retraining to avoid demotion. The disadvantage from an audit perspective of being involved in line operations was largely overcome by the power they wielded. This resulted in the line managers treating them with significant deference. With power came responsibility, however, and at least in Subject 1's case, he worked hard to act as an impartial judge. In the back of his mind, however, was the knowledge that an inappropriate act by line manager (even a relatively small act taken at a critical moment of judgment) could do severe damage to the organization and its reputation.

Thus despite the lack of a formal reporting line up the hierarchy of the organization, Subject 1's opinion that the operational internal auditors were very close to being of sufficient rank may be considered justified.

Question 6 There is a proper quality control procedure in place within the operational internal audit function

Subject 1 chose a 3 for this. Within the operational internal audit operation, generally adequate procedures exist to maintain standards. However since the departure of the senior staff spoken of earlier, the ability of the staff to bypass these procedures has increased.

Question 7 The operational internal audit function is recognised as important to the organization in that it adds value to the organisation

A 2 was chosen for this question. Operational internal audit is tolerated by the organization as a means of maintaining its credibility with the organization's suppliers, who would be loath to supply an organization they believed may give their product a bad name. Other than that, the purpose of operational internal audit is seen as of little value to the organization's leadership.

Question 8 The Organization has procedures to deal with ethical problems.

A 2 was selected here. The organization's method of dealing with ethical problems is nominal. In fact, overtly criminal acts would generally not lead to dismissal. The offender would be re-employed on release. From this perspective the organization is perhaps more socially advanced than many organizations. In the view of Subject one, this does cause difficulties in maintaining organizational discipline. It is, however, a contributing factor to the high clannishness that Subject one considers pervades the organization.

Question 9 The operational internal audit function is involved in the management of ethical problems.

A 2 was selected. Within its own area, because of the higher sense of responsibility, operational internal audit, was less clannish, less ad hoc and more hierarchical. Thus, an operational internal auditor's ethical attitude is more ethically strict. However, the higher clannishness of the organization as a whole means that the role of the clan in making ethical decisions virtually outweighs all other ethical considerations across the organization as a whole.

Question 10 The planning and procedures of the operational internal audit function conform with the professional standards.

A 3 was selected. The operational internal audit follows the minimum standards, thus the low score. However, the minimum standards are generally adequate to maintain the organization's desired level of activity without undue risk. It could be pointed out here than the combination of the equipment manufacturers efforts in designing operating processes for their equipment, combined with the strong rules-based ethos of the operational auditors has mitigated against the possible financial damage the organization could suffer in a totally ad hoc environment.

Question 11 . The risks the business faces, and operational internal audit procedures are reviewed regularly to ensure that the organization does not face unidentified risks.

A 2 was selected. Subject one considered that the organization did little proper assessment of the risks it faced. Instead it relied on ad hoc fixes when necessary. At the board level, the organization had little understanding of the risks it faced in day to day operations. At the lower level, the view was taken that ignorance is bliss.

Question 12 The operational internal audit function is cost effective to the organization.

The Subject chose a 3 for this question. Subject one considered that the organization's senior management had too much power to override controls, and accordingly the operational internal audit's overall effectiveness was constrained.

Question 13 The operational internal audit function is involved in the design of the financial internal controls.

Subject 1 chose a 1 for this question. Financial controls were imposed from above but when it came to operational controls, see question 14.

Question 14 The operational internal audit function is involved in the design of the non financial internal controls.

Subject one chose a 5. While operational controls were largely the result of the equipment supplier's recommendations, the operational internal audit did have some significant influence on the selection and implementation of the controls.

Question 15 Control self assessment is used regularly in designing the internal controls.

Subject one chose a 2 for this question. Formal controls are well established by both the equipment manufacturer and international standard setting bodies. The organization has accepted these controls and follows them. Accordingly control self-assessment is not used by the organization in considering formal controls. It is simply a question of massaging the controls to fit. Informal controls are not subject to any formal assessment criteria.

Question 16 All the internal controls are documented in procedures manuals.

Subject one chose a 3 for this question The formal controls are generally adequately documented, but informal controls are not documented at all. The 3 recognized the basic documentation of the formal controls.

Question 17 All internal control procedures are always followed.

Subject one chose a 4 for his response. While generally operational internal controls are followed, breaches are not uncommon.

Question 18 Effective undocumented internal controls exist within the organisation.

The Subject chose a 6 for this question. The organization is very much a clan, and as such it controls behaviour within the organization by clan influence rather than having written processes. As with most clans, the strong interpersonal influences act as strong unwritten controls.

Question 19 Undocumented controls are at least as important as documented controls.

For the reasons given at question 18, Subject one chose a 6 to be the correct value for this question, thus confirming the clannish nature of the organization.

Question 20 Staff involved in carrying out processes are involved in the design of controls over those processes.

This question was designed to test the answer to question 15. Question 15 used professional jargon, question 20 stated the same situation in plain language. The Subject readily recognized this and the resultant score was a 2.

Question 21 The operational internal auditor has free access to the board or a board committee.

The Subject chose a 2. The Board of Directors is not concerned with operational activities. Most of the persons at this level are appointed by each other, and are more interested on maintaining their position, and watching the organization grow, which as long as the economy generally is growing, cannot be avoided. They, therefore, largely ignore operational internal audit. As the process of operational internal audit has been successful in minimizing risks and thereby avoiding an event that would draw attention to any organizational failings, the board is happy to be ignorant of the details of the process.

Question 22 The operational internal auditor has assisted the organization to reduce the incident of loss through fraud.

The Subject chose a 2 for this as operational audit had little involvement in the protection of the organization from fraudulent loss. It was directed to protect the organization from loss as a result of mishandling of equipment.

Question 23 The operational internal auditor has assisted the organization to reduce/avoid losses generally.

Subject 1 considered that the effectiveness of operational internal audit mitigated against financial loss from the mishandling of and damaging of assets, customer’s consignments and customers and therefore chose a 6 for this question.

Question 24 All procedures are properly documented.

The Subject noted that while operational activities were generally well documented, overall documentation of procedures was mixed complete. This caused the Subject to select a 4 for this option.

Question 25 There is a strong degree of commonality of procedures across the organization.

The organization contained several operating divisions. These divisions did not have a system of effective communication between them, this resulted in each division "doing its own thing" and simply because of goal congruence, things worked in the end. For this reason a 2 was selected by Subject one.

6.3.2 Subject 2 of Organization 3

Subject 2 of Organization 3 held a line management role in Organization 3. He had previously worked in a similar organization for a long period, and had left that organization following a period of financial instability within the organization. He had joined Organization 3 because it appeared to have the "right political support" and in any case, he was well paid by Organization 3, and believed that his employment by Organization 3 would see him through to retirement, in about 5 years.

6.3.2.1 Subject 2's view of Organizational Culture of the Whole Organization

The values for the organizational culture identifiers for the organization as a whole selected by him were:

Clan: 20

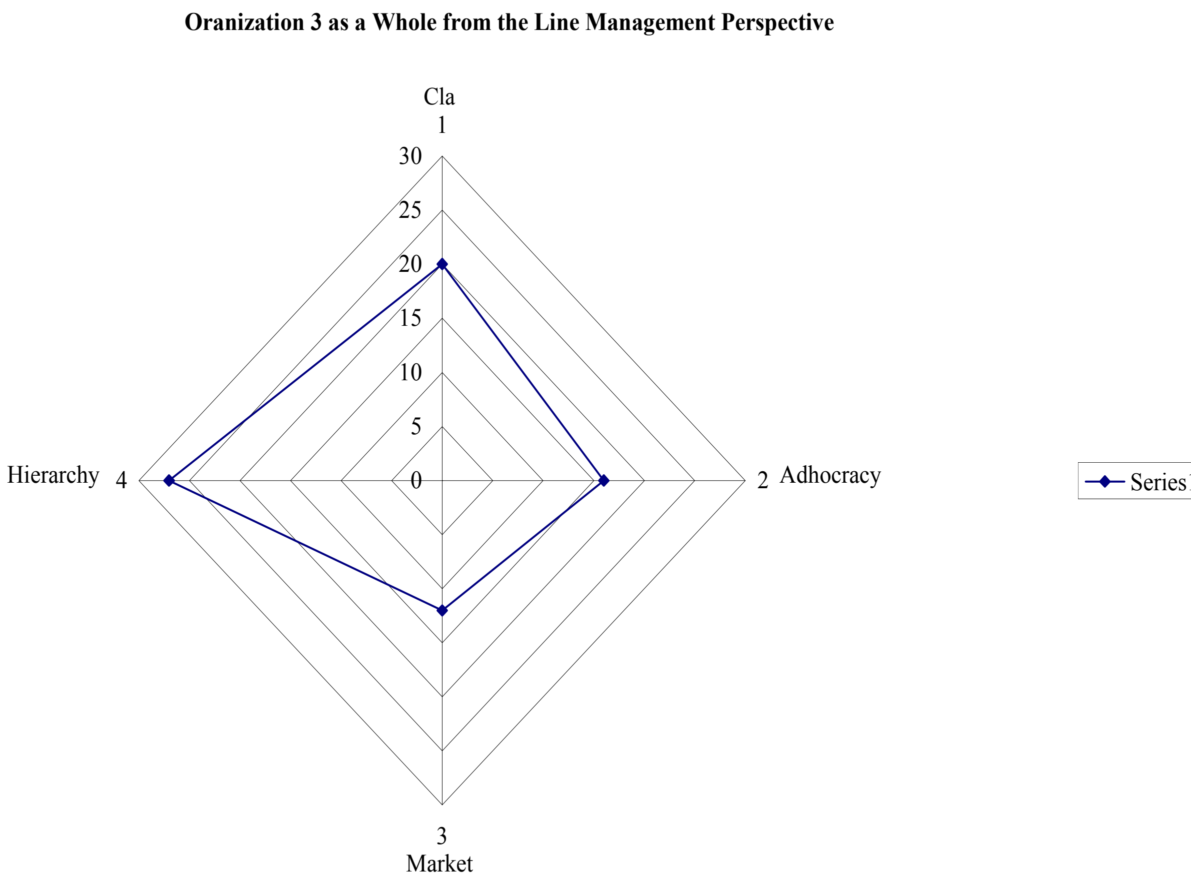
Adhocracy: 16

Market: 12

Hierarchy: 27

This was plotted on Figure 6.9

Figure 6.9



6.3.2.2 Subject 2's View of the Role of Internal Audit within Organization 3

Using the score:

Strongly agree = 7 to Strongly disagree=1 part C was answered as follows:

Question 1 The Operational Internal audit Process is planned in conjunction with both senior management/board and line management involvement

While internal audit planning took place, as far as Subject 2 was concerned, it did not involve line management, he, therefore, selected a 3 as a response to this question.

Question 2 All risks are properly identified and include in the audit process?

Subject 2 was of the opinion that only the line managers really understood the operational risks and thus believed that to reflect the shortfall of knowledge at the very high end of the organization, a 3 was appropriate for this question.

Question 3 The risk identification process is undertaken at a sufficiently high level within the organization.

For the same reason that he chose a 3 for question 2, Subject 2 chose a 3 for this question.

Question 4 Operational internal audit is independent of day to day management operations.

Subject 2 was aware of the regular contact with operational internal audit that he had in day to day operations. While he respected the ability of the operational internal audit to exert authority over ordinary line managers, he considered that the relatively hands on approach that operational internal audit took limited the level of independence of the operational internal audit from the line operations of the organization. He, thus, opted for a 4 for this question.

Question 5 The operational internal auditor is sufficiently senior.

Subject 2 considered that the senior management of the organization could, to some extent, influence line operational internal auditors, he, therefore, considered that a 3 was an appropriate selection for this question.

Question 6 There is a proper quality control procedure in place within the operational internal audit function

Subject 2 considered that the operation of the organization was of sufficiently good quality to not be concerned either was, and chose a 4 as a response.

Question 7 The operational internal audit function is recognised as important to the organization in that it adds value to the organisation

Similarly Subject 2 felt that as the operational internal audit role appeared to succeed adequately, it must be “adequate” and so was neutral about the role, thus, a 4 was chosen.

Question 8 The Organization has procedures to deal with ethical problems.

Subject 2 was again neutral here as he had not faced a direct ethical problem. Thus, again a 4 was selected.

Question 9 The operational internal audit function is involved in the management of ethical problems.

For the same reason as his answer to 8, subject 2 held a neutral position to this question and selected a 4.

Question 10 The planning and procedures of the operational internal audit function conform with the professional standards.

Again, as a line manager, Subject 2 did not get involved in the planning of operational internal audits and so held a neutral position, with a 4 as his response.

Question 11 . The risks the business faces, and operational internal audit procedures are reviewed regularly to ensure that the organization does not face unidentified risks.

On the other hand subject 2 considered that while most risks were understood by senior management, some where not so he opted for a 3 for this answer.

Question 12 The operational internal audit function is cost effective to the organization.

Subject 2 considered that, given the level of exposure he had to operational audit as a line manager, the operational internal audit would be reasonably cost effective, and thus he chose a 5 for this answer.

Question 13 The operational internal audit function is involved in the design of the financial internal controls.

Subject 2 considered that senior management have greater influence over financial internal controls than line auditors, and, accordingly, chose a 3 for this question.

Question 14 The operational internal audit function is involved in the design of the non financial internal controls.

Subject 2 was neutral about this point, he considered that most internal controls were externally set, however the operational internal audit did influence their interpretation. Thus, Subject 2 chose a 4.

Question 15 Control self assessment is used regularly in designing the internal controls.

Subject 2 was confused about the concepts behind control self assessment. He, therefore, took a neutral position and chose a 4 again.

Question 16 All the internal controls are documented in procedures manuals.

Subject 2 was convinced that the procedures manuals he relied upon contained nearly all he needed to know to handle most operational activities, he, therefore, chose a 6.

Question 17 All internal control procedures are always followed.

While the procedures manuals were complete and detailed, subject 2 did not consider that they were followed as rigorously as perhaps they could be. He thus selected a 3 for this question.

Question 18 Effective undocumented internal controls exist within the organisation.

At the same time he was neutral about the effectiveness of undocumented controls, so chose a 4.

Question 19 Undocumented controls are at least as important as documented controls.

But with regard to the importance of these undocumented controls, Subject 2 considered them of some importance and so chose a 5.

Question 20 Staff involved in carrying out processes are involved in the design of controls over those processes.

This question, which was designed to test question 15, indicated that the subject when faced with a more direct and less “jargon” based question did not think that line managers had sufficient input into control design, he therefore chose a 2.

Question 21 The operational internal auditor has free access to the board or a board committee.

Subject 2 did not consider that the Board took significant interest in the role of the operational internal auditor. He therefore selected a 2. This was consistent with Subject 1’s selection.

Question 22 The operational internal auditor has assisted the organization to reduce the incident of loss through fraud.

Subject 2 considered that any form of oversight would help prevent loss through fraud, so he chose a 7 for this question.

Question 23 The operational internal auditor has assisted the organization to reduce/avoid losses generally.

On the other hand he considered that the operational internal audit was less effective, and while it would prevent losses generally, he was not convinced a score of 7 was appropriate, so he selected a 5 for this question.

Question 24 All procedures are properly documented.

Subject 2 considered that while documentation was extensive, it did not cover all procedures, and accordingly he selected a 3 for this question.

Question 25 There is a strong degree of commonality of procedures across the organization.

While subject 1 recognized some commonality across the organization, he did not consider it to be sufficient to warrant more than a 3 for this question.

6.4 Other Matters Considered Important to the Research

One important measure of the effectiveness or otherwise of an organization's operational internal auditor, especially in the transport industry is the measure of safety of the operation. Obviously transport operations face exogenous risks, but the extent to which proper procedures can mitigate against risk is significant. As the safety record of each of the organizations was a matter of public record, it was not necessary to make direct enquiry as to the accident record of each organization. Thus it can be noted that, as of writing, the safety records of each organization would rank organization 1 first, with organization 3 next with a passable record, and organization 2 having a significantly worse record.

CHAPTER 7.

DISCUSSION OF RESULTS

7.1 Overview of Responses to Questionnaire Part C

An overview of responses is supplied in Table 7.1

Table 7.1: Comparative Table of values for the Questionnaire's Part C Questions

Question	Organization 1		Organization 2		Organization 3	
	Operational Internal Audit	Line manager	Operational Internal Audit	Line Manager	Operational Internal Audit	Line Manager
1	6	6	5	5	4	3
2	6	5	5	6	4	3
3	7	5	5	3	4	3
4	6	6	6	5	4	4
5	6	6	6	5	3	3
6	6	5	6	3	3	4
7	6	5	6	5	2	4
8	6	2	7	3	2	4
9	6	1	3	3	2	4
10	5	6	6	2	3	4
11	5	2	6	2	2	3
12	4	6	5	5	3	5
13	1	1	5	5	1	3
14	6	5	5	5	5	4
15	5	1	5	3	2	4
16	7	3	6	2	3	6
17	5	4	5	3	4	3
18	5	2	5	3	6	4
19	6	2	5	6	6	5
20	6	1	4	3	2	2
21	1	1	6	6	2	2
22	1		6	2	2	7
23	6		6	3	6	5
24	5	2	6	2	4	3
25	5	3	5	2	2	3

7.2 Analysis of Overview of Responses

It should be noted that because each organization is an individual entity. There are two levels at which the values selected by the subjects may be compared. The first is intra firm, the second is across firms. Thus, at one level, the values that have been selected by Subject 1 and Subject 2 within a firm may be compared for consistency, at the other level, the values selected by the subjects within one firm may be compared with the values elected by the subjects of other firms. It also must be kept in mind that the questions within this section were designed to reinforce one another.

The comparison of views across organizations is discussed in this chapter at section 7.5, where the questions are grouped by relevance into sections covering (1) the value of internal control, (2) The value of the operational internal auditor, (3) the involvement of the operational internal auditor in ethical considerations, and (4) the extent to which the organization uses the tool of control self assessment as a device for mitigating conflict between line managers and the operational internal auditor.

Examining the Table indicates that in the majority of questions, there is comparatively little disagreement between the operational internal auditor and the line manager in their chosen answers. Probably the most interesting is relative to question 16, which asks inversely about the extent of undocumented or informal controls. Such controls should be at a minimum level if the organization values its internal controls, yet while the operational internal auditors of organizations 1 and 2 do not consider them to exist to any extent, the line managers do consider them to exist. On the other hand, within organization 3, the line manager dismisses the existence of significant levels of informal controls while the operational internal auditor considers that they exist. This is discussed further in section 7.10. The other major difference is that between the operational internal auditor and line manager of organization 2 over ethics (question 8). The operational internal auditor of organization 2 considers ethics to be properly managed by organization 2, the line manager considers the management process to be weak. The overall responses to this question will be discussed in section 7.8. There were other differences, but except for the differences between the line manager and the operational internal auditor of Organization 2 as to the value of internal audit discussed in section 7.8, because of the number of questions reinforcing a particular area, they did not significantly alter the overall outcome for that area.

7.3 Approach to the Results

The rest of this chapter will be divided into three principal sections. The first part will summarize the responses from the six subjects by position and organization. The second part will compare the cultural aspects of each of the organizations as a whole as against each organization's internal auditor culture for the three organizations examined. The third part will examine the way each of the three different organizations utilized and valued internal controls, the operational internal auditor, ethics, and control self assessment.

7.4 Analysis of Responses to Questionnaire Parts B and C

The following section 7.4 summarizes the culture of each organization's operational internal audit, and the corresponding culture of that organization. Section 7.5 discusses these outcomes. Then sections 7.6 to 7.10 summarize the responses to part C of the questionnaire.

7.4.1 Summarized Cultural Responses of Each Subject (Part B)

7.4.1.1 Organization 1's Subjects

7.4.1.1.1 Organization 1 Subject 1

Organization 1 Subject 1 saw the internal audit section as principally a rules-based or hierarchical/bureaucratic group, with very little acceptance of ad hoc activity. The rules were seen as significantly more important than either the market or the organization as an extended family. This compares to the view of the organization as a whole, where the hierarchy or bureaucracy fought for dominance in the organization with the desire to meet the requirements of the market.

7.4.1.1.2 Organization 1 Subject 2

Organization 1 Subject 2's opinion of the culture of the organization matched Subject 1's opinion very closely. The only difference was that Subject 2 felt that in any conflict between hierarchical/bureaucratic rules and the market, the market would come a very close second. He held this position because he believed that the power of the operational internal auditor counter-balanced the power of the market. He also believed that the organization saw advantages in projecting an image of strong governance as a marketing tool. The result further improved the position of the operational internal auditor.

7.4.1.2 Organization 2's Subjects

7.4.1.2.1 Organization 2 Subject 1

Organization 2 Subject 1's view of the operational internal audit of Organization 2 was that it was virtually trying to be culturally everything at the same time. The only exception was the level of adhocracy, which was slightly less than maximum. The ranking of the operational internal audit section's acceptance of adhocracy, while slightly restricted, was still very much higher than the ranking chosen by either Organization 1 or Organization 3's operational internal audit sections. Further while the level of acceptance of adhocracy by both the other organization's operational internal audit section was significantly less than that given to adhocracy by either of the other two organizations as a whole, this was not the case with Organization 2. While the other two organizations had operational internal audit sections that appeared to be almost ad hoc adverse, Organization 2's operational internal audit accepted adhocracy, in fact, almost embracing it, as "getting the job done" was very important.

Organization 2's Subject 1 considered Organization 2 as a whole to be primarily a market-driven hierarchy. During the interview Subject 1, while not directly stating the fact, implied that fear would be a tool of control within Organization 2. It appeared to be a driving force behind the tendency of the operational internal audit sections apparently contradictory tendency to try to be a clannish market-driven bureaucratic adhocracy. Being all things to all men avoided conflict within the organization. This may have limited the effectiveness of the operational internal audit.

7.4.1.2.2 Organization 2 Subject 2

Organization 2 Subject 2's view of Organization 2 is somewhat different from Subject 1s'. But the difference is a logical outcome of Subject 1's view that allows for a higher level of adhocracy at both the organizational and operational internal audit level. Subject 2 considered the organization to be a market driven adhocracy. Subject 2 did however make one interesting comment.

In his comments on the organization's management style, Subject 2, a line manager of Organization 2, stated that a "culture of fear" existed in Organization 2. While this view was not reflected in any of the remarks of the operational internal auditor of Organization 2, it may, in part, explain the outcome of the cultural evaluation of the operational internal audit for Organization 2. The operational internal audit appeared to be trying to meet conflicting needs by giving virtually the same priority to each need. It is highly likely that this desire to meet all conflicting needs was driven by the underlying culture of fear that was identified by the line manager.

It should be noted that within all three organizations the operational internal auditors were drawn from line mangers. As a result, while they had a strong cultural affinity to the internal audit role, as shown by the way they identified their culture as operational internal auditors, they also had, as a result of their experience, a strong affinity to the role of the line manager.

There is no evidence that such a culture of fear existed in either of the other two organizations. In both those organizations, the operational internal audit section, in particular was more independent within the organization, and better able to resist external pressures than the operational internal audit section within Organization 2.

7.4.1.3 Organization 3's Subjects

7.4.1.3.1 Organization 3 Subject 1

Organization 3 Subject 1's view of the operational internal audit section of Organization 3 was of a strongly clannish rules based hierarchy/bureaucracy with very similar culture to Organization 1's operational internal audit. Organization 3's operational internal audit was more clannish, but otherwise with the strong hierarchical/bureaucratic interest in the following of rules. This desire to follow rules that leads to the operational internal audit being considered a bureaucratic clan lines up with the situation in Organization 1. The absence of fear as a control tool may be the major reason that the operational internal audit of organizations one and three are more closely aligned to each other and relatively remote culturally from Organization 2's operational internal audit.

From Subject 1's position, Organization 3 as a whole was strongly orientated towards being a clannish bureaucracy. The clannishness was reinforced by his view that the senior members of the organization behaved as if they were members of an "old boys club".

7.4.1.3.2 Organization 3 Subject 2

Organization 3 Subject 2 held a very similar view of Organization 3 as a whole to that held by Subject 1, that is, the organization was a clannish bureaucracy. He arrived at this conclusion for basically the same reasons as Subject 1.

7.5 The Differences in Organizational Culture

Organization 1 has a culture that both Subjects view as being largely a market driven hierarchy/bureaucracy. With minor differences, both Subjects have a consistent view of the organization. Thus, it could be argued that the organization has a culture that was recognized by both the internal auditor and the line manager. Further both these members of the organization held a consistent view of the organization's culture and, therefore, could relate to each other within the organization. This has clear behavioural implications. The organization's members have a clear understanding at the management and internal audit levels of the organization of the culture of the organization and, therefore, the behaviour that is expected of each of them as a result. There is little room for misunderstanding.

On the other hand, Organization 2's Subjects, who are only one step removed from each other in the hierarchy of the organization, have diametrically opposing views on key aspects. The operational internal auditor sees the organization as having a similar culture to Organization 1. However, the line manager sees the organization as having a far more clannish and ad hoc form of culture. This is an indication of mismatched culture within the organization. Worse, viewed at the line level, the organization is seen as having a culture that, as will be explained later, is not suitable for the safe operation of the organization. One point of significance, however, is the fact that both Subjects considered that the organization used "fear" as an effective organizational glue rather than loyalty and mutual trust or the desire to be innovative or goal achieving or looking to have a smooth-running operation. This may have the effect of skewing the perceptions of the parties, as the lower down the organizational structure, the stronger this fear would be. Thus, the greater the desire of the members of Organization 2 to please senior management and, therefore, the greater willingness to act in an ad hoc manner and take risks which in the view of the member would, if successful, please senior management. This, in itself, makes the perception of the operational internal auditor that the culture contains a strong bureaucratic element worthy of note. The cause of the operational internal auditor's position may be that he views fear as a useful tool for a bureaucracy to obtain a smooth-running organization.

This is shown by the over-emphasis on all aspects of all the cultural discriminators, that are displayed in the chosen cultural model, at the higher level of Organization 2. At the higher level of management Organization 2 sees itself as a feel-good clan, a successful marketer, able to be flexible in decision making and yet simultaneously strongly rules-orientated. Yet, if a member fails to achieve the desired goals, punishment will be used. As a result, Organization 2 has no real certainty of direction. When it comes to choosing between an ad hoc decision and a rules-based decision, which way the middle management will go depends on how the manager responsible will view senior management's desires. This is further driven home if Organization 2's management style is considered. Management have a strongly hierarchical approach, but at the same time attempt to be clannish in their behaviour. They use a “carrot and stick” approach in managing a highly skilled organization, on the basis that without threats and coercion the organization would become unmanageable.

At the lower level of line management, the confused signals are misread. There appears to be more emphasis on the market than clannish values, and greater willingness to take ad hoc approaches to problems in the interests of flexible decision making, which weakens the obedience to rules called up by a hierarchy. This has implications for the organization as a whole, as it operates in an environment where processes and procedures are critical to maintaining safety.

The result is a willingness by the members of organization 2 to attempt to be flexible with the rules (ad hoc) in order to satisfy the market. The real danger here is that most of the rules are there to ensure that the organization operates safely. By disregarding the rules the organization weakens substantially the safety that can surround a hierarchy with sound safety-based rules.

This is in contrast to Organization 3, which is at least more interested in rules, despite its strong clannish nature. The effect is that Organization 3 has created a similar cultural profile to Organization 1.

7.6 The Differences in Approach to the Internal Controls by each Organization

When considering the Part C questions, these have been grouped and summarized on the basis for the underlying purpose of the questions, as several questions were asked about particular items to reinforce the outcome.

Strongly positive answers to questions 3, 16, 17, 24 and 25 indicate that the organization values operational internal controls. Conversely, negative answers to these questions indicate that the organization places a low value on the role of the operational internal control. At the same time, positive answers to questions 18 and 19 would imply that internal control systems contained hidden weaknesses, in that undocumented controls were being considered important. The average scores for questions 3, 16, 17, 24 and 25 are:

Organization1: 4.6

Organization 2: 3.9

Organization 3: 3.5

Thus only Organization 1 appears to value internal controls both, other organizations seem to accept them as a fact of life while being very marginally negative about them.

7.7 The Differences in Approach to the Operational Internal Auditor by Each Organization

Similarly strongly positive answers to questions 1, 4, 5, 6, 7, 10, 11, 12, 13, 14, 21, 22, and 23 indicate that the organization values the contribution of the operational internal auditor. Conversely, negative answers to these questions indicate that the organization places a low value on the role of the internal auditor. The average scores for these questions for each of the organizations are:

Organization1: 4.0

Organization 2: 5.3

Organization 3: 3.8

Thus while Organization 1 has a weakly positive view of the operational internal audit role, and Organization 3 has a virtually neutral view,. Organization 2 is strongly positive. It is interesting that there were significant disagreements here as to the values to be placed on questions 6, 10, 11, 21, 22 by the line manager and the operational internal auditor, with the line manager opting for very low values and the operational internal auditor opting for very high values. This suggests that while Organization 2 appears to place a high value on operational internal audit this outcome has been driven by the high values put on the operational internal audit by the operational internal auditor,. In fact there would appear to be a stronger conflict between line manager and operational internal auditor over the value of operational internal audit within Organization 2 than within the other two organizations.

7.8 The Differences in Approach to Ethical Questions by each Organization

Strongly positive answers to questions 8 and 9 indicate that the operational audit is involved in ethical considerations. This indicates that the operational internal audit's role is wider than simply practical considerations. To the extent that safety may be considered an ethical factor, and the operational internal auditors were deeply involved in safety, some ethical involvement would be expected. The average scores for these questions for each of the organizations are:

Organization1: 3.8

Organization 2: 4.0

Organization 3: 3.0

From this it can be seen that organizations 1 and 2 place some small positive value on ethics while Organization 3 does not.

7.9 The Differences in Approach to the use of Control Self-Assessment by each Organization

Questions 15 and 20 consider the extent to which control self-assessment or a version of it is used to reduce tensions between the operational auditor and the line manager being assessed. Strong positive answers to this question mean that the balance of power between the operational internal auditor and the line manager is not as strongly in favour of the auditor as would be the case with negative answers. The average scores for these questions for each of the organizations are:

Organization1: 3.3

Organization 2: 3.8

Organization 3: 2.5

From this it can be seen that while Organization 1 is virtually neutral with regard to acceptance of line management input into the control systems that they work under, and

Organization 3 finds it anathema, Organization 2 is slightly receptive to the idea of taking line manager advice as to the nature of the controls under which they work.

Organization 1's ambivalence may be due to an unfortunate event shortly before the study commenced which involved the following by the organization of a suggestion put forward by one line manager, with embarrassing but not deadly consequences.

7.10 The Influence of Informal (Undocumented) Internal Controls within each Organization

Strong positive answers to questions 18 and 19 would indicate the existence of influences that the operational internal auditor could not audit undocumented control procedures. The average scores for these questions for each of the organizations are:

Organization 1: 3.8

Organization 2: 4.8

Organization 3: 5.3

These results indicate that while the operational internal auditors are most highly respected in Organization 2, they find themselves in a situation where they face significant ad hoc controls. Further ad hoc controls exist more strongly than in Organization 1. Yet ad hoc controls also appear to exist strongly in Organization 3. It would appear that success of the operational internal audit rested not on formal declarations of independence, but on the fact that within the other two organizations, the individual operational internal auditors were unwilling to be subservient to the organization if it meant “bending the rules”. Thus it would appear that fear has played a part in determining the behaviour of the line managers and operational internal audits of Organization 2.

7.11 Summary of Results

In simple terms the overall outcome is that Organizations 1 and 3 accepted operational internal audit without undue conflict. And at the same time the operational internal audit within Organizations 1 and 3 were strongly bureaucratic/hierarchical. This is in contrast to Organization 2, in which there was a conflict between the line managers and the operational internal audits over the value of the operational internal auditor, and at the same time both parties accept undocumented internal controls. There also appeared to be an element of subservience to senior management by both the operational internal auditor and the line managers in Organization 2 that did not exist in the other organizations.

CHAPTER 8

CONCLUSIONS

This chapter examines the outcome of the research in explaining how an organization's internal audit section interacts with the organization itself as far as answering the six research questions is concerned.

Initially, each of the six research questions set out in Chapter One will be taken in turn, and the findings of the research applied to the questions. Following that, the overall implications of the research will be discussed.

8.1 Does the Internal Audit Section within an Organization have an Organizational Culture Identifiably Distinct to the Culture of the Organization within which it Operates?

In the three organizations examined it is apparent that the organizational culture of internal audit can be recognized as different from the organization as a whole.
While both the line manager and the operational internal auditor in Organization 1 considered that the organization was a market driven hierarchy, with a strong market tendencies, the operational internal auditor at Organization 1 scored the operational internal audit at 40 for hierarchical/bureaucracy and a minimal score for adhocracy. At the same time he did not see his section giving as much weight to the market as he saw the company as a whole. In his view, his organization was both more ad hoc orientated and more market driven than his operational internal audit section.

His view of the company as a whole corresponded closely with the view of that organization held by the line manager.

The operational internal auditor of Organization 2 saw the culture of the operational internal audit as trying to satisfy all needs. Thus, it contained both a bureaucratic and an ad-hoc organizational culture within the operational internal audit area. At the same time both he and the line manager of Organization 2 held a strong view that the organization was very market driven, more so than the internal audit section; even given the high values he gave the internal audit section. Further he gave the operational internal audit section a higher value for hierarchy/bureaucracy than he gave the organization as a whole. The line manager's view of the culture of the organization as a whole matched his views.

The operational internal auditor of Organization 3, on the other hand, held a similar cultural position to the operational internal audit of Organization 1. Strongly bureaucratic, and partly clan orientated and market orientated with little interest in an ad hoc culture. Again his views of the organization as a whole matched the views of the line manager, except that the line manager considered that the organization to be more ad hoc.

Thus, in all three organizations the culture of the organization as a whole as plotted by both the line manager and the operational internal auditor was distinctly different from the culture of the operational internal audit as plotted by the operational internal auditor.

8.2 If the Internal Audit Section within the Organization does have an Organizational Culture Distinct from the Culture of the Organization within which it Operates, What Types of Differences Exist?

The operational internal audit of Organization 1 saw itself as being more clannish and more hierarchical/bureaucratic than Organization 1 as a whole.

While the operational internal audit of Organization 2 only exhibited only slight differences relative to Organization 2 as a whole, there was a difference which suggested that the operational internal audit section had a more strongly bureaucratic culture and a more strongly clannish culture than the organization as a whole.

The operational internal audit of Organization 3 was more bureaucratic than the organization as a whole. Organization 3 was considered as clannish as the operational audit section by the operational internal auditor. Thus, while the clannishness of the operational internal audit was high, it was not higher than the organization as a whole. However the high level of bureaucratic/hierarchical values shown in the operational internal audit section of Organization 3 was not matched by the organization as a whole.

Thus, all the operational internal audit sections of all the organizations see themselves as being more bureaucratic/hierarchical than the respective parent organization as a whole, and also very clannish.

While the research was restricted to three organizations, and therefore no statistical inference can be made, this outcome may apply to other organizations across the same industry.

Thus, the outcomes imply that within this industry the operational internal auditors see themselves as being part of a clan with separate values to the organizations within which they work, in particular in relation to the following of rules (bureaucracy/hierarchy). The clannishness may be related to the fact that they recognize themselves as being members of a group with a very high skill set. This is reinforced by the fact that they are selected from line managers to undertake the function by the senior operational internal auditor because that person considers them to be above average in the skill set they possess.

8.3 Is the Culture of the Internal Audit Section Influenced by the Culture of the Organization as a Whole?

This is a more difficult question to answer from the data available. This is partly due to the fact that Organization 2's organizational culture was interpreted substantially differently by the internal audit subject when compared to the interpretation given by the line manager. While the operational internal auditor saw the organization as a market driven hierarchy/bureaucracy, the line manager saw organization 2 as a market driven adhocracy. However, the line manager stated that fear was used by the organization as a control tool. The operational internal auditor did not mention fear, and it was not put to him directly; however, indirectly he did indicate that fear was used to control staff on occasion.

When compared to the other two organizations, where fear was not mentioned as a control device by any of the subjects, it appears likely that the use of this control device may have influenced the outcome for Organization 2, in that the operational internal auditor appeared to be trying to be “all things to all men”. Thus the operational internal audit section was a strongly bureaucratic/hierarchical market driven clan with a desire to be flexible (ad hoc) as necessary to meet the requirements of senior management. In fact, this created a conflict within the operational internal audit that was only just resolved in favour of bureaucratic/hierarchical rules based approach. When pressed, the operational internal auditor stated that following the rules was of paramount importance. This resolution was driven by the fact that what appears to be the underlying culture of operational internal auditors generally, that is a desires for a bureaucratic/hierarchical rules based system, was too strong to be overridden by the desires of senior management.

From that perspective the operational internal audit of Organization 2 does appear to have been influenced by its organization. This does not appear to have been the case with the operational internal auditors of Organizations 1 and 3, who, while they have quite different organizational cultures, have operational internal audit sections that have cultures that do not appear to be subservient to the organizations’ own cultures. Thus, a risk of tension between the operational audit and the organization under examination would appear to exist in these two organizations. The result, therefore, would appear to be that the organizational culture of the organization as a whole can have a significant influence on the operational internal audit in situations where fear is used to suppress the independence of the culture of subsections of the organization, including the operational internal audit section. Where this tool is not used, operational internal audit will assert its cultural independence to a much greater degree. When this happens the operational internal audit's culture will reflect the attributes of both a strong rules-based culture, and a clan of persons with common values, and attach substantially less importance to the market, while being averse to ad hoc actions..

8.4 Do the Cultures of the Different Internal Audit Sections in Different Organizations have Commonalities that Exist Despite the Organizational Cultures of Different Organizations being Different?

The answer to this question would appear to be yes. Within all three organizations, the operational internal auditors were all strongly bureaucratic. This held for Organization 2 as well as for both Organization 1 and Organization 3. Even though in Organization 2 the operational internal audit section was also willing to be ad hoc, it still indicated that it was strongly bureaucratic. This bureaucratic desire existed even though the operational internal audit was influenced or pressured into accepting other cultural aspects of the parent organization (in particular, the tendency to be ad hoc) that were not considered by the operational internal audit of the other two organizations as being anywhere nearly as important.

It should be noted, however, that a strongly bureaucratic attitude and clannishness is where the commonality between organizations ended, and that while the operational internal audit sections of both Organization1 and Organization 3 had very similar cultures, the differences between them and the operational internal audit section of Organization 2 were substantial. Also while the subjects from Organization 1 had a very consistent view of Organization 1's culture, and the subjects from Organization 3 had a reasonably consistent view of that organization's culture, Organization 2's subjects had an inconsistent view of the organization's culture. It appears that this difference was largely driven by the fear tool being used by the senior management of Organization 2 as a control device.

Perhaps the situation could be summarized by noting that since privatization, Organizations 1 and 3 had been relatively safe by the standards by which these types of organization measure their records, while Organization 2 had not. Perhaps this is because Organization 2's operational internal audit is more willing to accept an ad hoc approach than either of the other organizations' operational internal audit. The confirmation of this situation will require further research. It appears, however, that some resistance to the admission of its weaknesses exists within Organization 2. This resistance appears to flow from a firm belief that it is the best, and accordingly the way it operates must also be the best.

8.5 Do these Differences Lead to Tensions within the Organization?

While it must be remembered that this is not a statistical exercise, the implication of the cultural model outcomes is that there will be some tension between the operational internal auditor and line managers. This is in line with comments from the line manager from Organization 1, who remarked that sometimes the desire to follow rules exhibited by operational internal auditors was considered extreme by the line managers. Thus, in at least one case, tensions are seen to exist. This is in line with the implications of the statement about the need for diplomacy by operational internal auditors outlined by Allen (1967).

The tensions appear to be more far reaching for Organization 2, in that Organization 2 appears to have applied sufficient pressure to the operational internal audit role that the operational internal auditors are more willing to accept ad hoc activities that either of the operational internal auditors in Organizations 1 and 3. Such approaches would be anathema to the operational internal auditors in Organizations 1 and 3. It must be noted that the operational internal audit roles in these organizations (and in particular in Organization 1) have a high level of independence. This means that the tensions created are often resolved in favour of the operational internal auditor.

8.6 If so are These Tensions Likely to be Destructive or Productive?

One approach to this question is to consider the outcomes for the different organizations. As stated earlier, one measure of operational audit outcomes, because it is a principal objective of the operational internal audit, is the safety of the organization. Organization 2's operational internal audit while very rules-orientated in the same way as the operational internal auditors of the other two organizations, was also strongly orientated in the other aspects of the cultural model as well (market, clan, and adhocracy). The particular attitude to adhocracy would seem to be anathema to a rules-based bureaucracy, yet the operational internal audit reflected the corporate "can do" attitude. Unfortunately, Organization 2 had the worst safety record. The operational internal auditors of the other organizations were strongly bureaucratic, and largely concentrated on that direction, regardless of the organizational culture of the organizations as a whole. Both organizations had far better safety records than Organization 2. Thus it would appear that if there is such a potential for tension, that the operational internal auditor is willing (or required by senior management) to give ground then the audit process will fail more often than in a situation of tension where the balance of power is more in favour of the operational internal auditor. The importance with which the operational internal audit is regarded appears less important than the ability of the operational internal audit function to assert its cultural independence from the organization as a whole.

8.7 Conclusion

The study can be summarized as contributing the following to the research on both organizational culture and sub-cultures with an organization in regards to the interplay between the organization's culture as a whole and the sub-culture of an organization's operational internal audit section, and how that may influence the organization's use of internal controls.

1. The operational internal auditor has a unique culture within an organization different from the organization's culture as a whole.
2. The operational internal auditor's culture tends to be far more bureaucratic than the organization as a whole.
3. The operational internal auditor's culture is also strongly clannish, generally more so than the organization as a whole. In this regard the nature of the clannishness is in favour of the operational internal auditors rather than the organization as a whole. In other

words, the operational internal auditors see themselves as being "superior" to the run of the mill line managers from whom they have been selected.

4. Tensions between the organization and the operational internal auditor will exist because of the cultural difference, and the strong bureaucratic/hierarchical culture of the operational internal auditor which is reflected in the strong desire to follow rules.

5. These tensions are strongest when the operational internal audit is not strongly imbued with the organizational culture of the whole organization and thus does not have a culture that is subservient to that of the organization as a whole.

6. At least some cultural difference and, therefore, tension between the organization and its operational internal audit is a good thing, as it appears to avoid the operational internal auditor coming under the influence of the organization to the point at which independence is lost, and with it the value of the operational audit as a way of "keeping the organization on the straight and narrow". This is demonstrated by the differences in outcomes for Organization 2 as against Organizations 1 and 3.

8.8 Further Research

This study is a series of three case studies, and therefore, while the inferences drawn may fit a general model of organizational behaviour relative to internal control and audit, there is a need to expand the data if the understanding of the area is to move from inference to statistical confidence. Accordingly there is opportunity for further research to be undertaken across a wider selection of organizations in different fields of activity besides transport, to discover if the inferences can be extended to general rules. At this stage, the author has been unable to find any general research in this area which examines the balance of the culture of an organization with the sub culture of the internal audit and the effect of this balance on the internal controls. This specific research would indicate that such general research would yield useful data. There are, however difficulties involved because of the depth of data required.

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APPENDII

Appendix 1

The Structured Interview Questionnaire/Guide

Organisational Culture Questionnaire

<u>NB: Please indicate your perceptions</u>

Part A.

Please Select the most appropriate choice as regards your organization:

1. Classification of principal area of activity of the organization:

(a) Banking and finance [ ]

(b) Government agency or department [ ]

(c) Education [ ]

(d) Public utility [ ]

(e) Property [ ]

(f) Commerce and commercial services [ ]

(g) Industry and manufacturing [ ]

(h) Not for profit organization [ ]

(i) Conglomerate (multiple industries) [ ]

(j) Transport, and tourism [ ]

(k) Other (please specify) [ ]

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2. What size is your organization in terms of number of employees?

(a) 500 or less [ ]

(b) 501 to 1,000 [ ]

(c) 1,001 to 2,500 [ ]

(d) 2,501 to 5,000 [ ]

(e) over 5000 [ ]

3. What size is your organization in terms of annual turnover or budget allocation for the current year (AUD millions)?

(a) under 50 [ ]

(b) 51 to 150 [ ]

(c) 151 to 250 [ ]

(d) 251 to 350 [ ]

(e) 351 and over [ ]

Part B.

Please answer the following six questions by reading each statement, and indicating on the seven point scale the extent to which you agree with the statement.

1. Dominant characteristics:

(a) The organization is a very personal place like an extended family

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(b) The organization is very dynamic and entrepreneurial. People take risks.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(c) The organization is results oriented competitive and achievement oriented

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(d) The organization is very controlled and structured with formal procedures

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

2. Organisational leadership:

(a) The leadership is generally considered to exemplify mentoring, facilitating or nurturing

Strongly Agree						Strongly Disagree
7	6	5	4	3	2	1

(b) The leadership is generally considered to exemplify entrepreneurship innovating and risk taking

Strongly Agree						Strongly Disagree
7	6	5	4	3	2	1

(c) The leadership is generally considered to exemplify no-nonsense aggressive results oriented focus

Strongly Agree						Strongly Disagree
7	6	5	4	3	2	1

(d) The leadership is generally considered to exemplify coordinating, organising and smooth running efficiency.

Strongly Agree						Strongly Disagree
7	6	5	4	3	2	1

3. Management of employees:

(a)The management style in the organization is characterised by teamwork consensus and participation

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(b)The management style in the organization is characterised by individual risk taking, innovation freedom and uniqueness

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(c) The management style in the organization is characterised by hard driving competitiveness, high demands and achievement

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(e) The management style in the organization is characterised by Security of employment, conformity, predictability, and stability in relationships

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

4. Organizational Glue:

(a) The glue that holds the organization together is loyalty mutual trust and commitment

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(b)The glue that holds the organization together is innovation, development and the desire to be at the cutting edge

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(c)The glue that holds the organization together is the emphasis of mutual goal accomplishment, and winning

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(d)The glue that holds the organization together is formal rules and policies to achieve a smooth running operation

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

5. Strategic emphasis:

(a)The organization emphasises human development, high trust, openness and participation

Strongly Agree							Strongly Disagree
	7	6	5	4	3	2	1

(b) The organization emphasises creating new challenges and trying new things

Strongly Agree							Strongly Disagree
	7	6	5	4	3	2	1

(c) The organization emphasises competitive actions and achievements especially winning in the market

Strongly Agree							Strongly Disagree
	7	6	5	4	3	2	1

(d) The organization emphasises permanence, stability efficiency control, and smooth running

Strongly Agree							Strongly Disagree
	7	6	5	4	3	2	1

6. Criteria for success:

(a) The organization defines success on the basis of the development of human resources, teamwork, mutual commitment

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(b) The organization defines success on the basis of being a product leader with the newest most unique product

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(c) The organization defines success on the basis of winning in the marketplace. Competitive market leadership is the key

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

(d) The organization defines success on the basis of efficiency and smooth operations, with dependable delivery

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

Part C. Operational internal audit and Internal Control

1. The operational internal audit process is planned in conjunction with both senior management/board and the line management involvement.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

2. All risks are properly identified and included in the audit process.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

3. The risk identification process is undertaken at a sufficiently high level within the organization.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

4. Operational internal audit is independent of day to day management operations.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

5. The operational internal auditor is sufficiently senior.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

6. There is a proper quality control procedure in place within the operational internal audit function

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

7. The operational internal audit function is recognised as important to the organization in that it adds value to the organisation

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

8. The Organization has procedures to deal with ethical problems.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

9. The operational internal audit function is involved in the management of ethical problems.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

10. The planning and procedures of the operational internal audit function conform with the professional standards.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

11. The risks the business faces, and operational internal audit procedures are reviewed regularly to ensure that the organization does not face unidentified risks.

Strongly Agree Strongly Disagree.

7 6 5 4 3 2 1

12. The operational internal audit function is cost effective to the organization.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

13. The operational internal audit function is involved in the design of the financial internal controls.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

14. The operational internal audit function is involved in the design of the non financial internal controls.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

15. Control self assessment is used regularly in designing the internal controls

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

16 All the internal controls are documented in procedures manuals

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

17. All internal control procedures are always followed

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

18. Effective undocumented internal controls exist within the organisation.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

19. Undocumented controls are at least as important as documented controls

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

20. Staff involved in carrying out processes are involved in the design of controls over those processes.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

21. The operational internal auditor has free access to the board or a board committee.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

22. The operational internal auditor has assisted the organization to reduce the incident of loss through fraud.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

23. The operational internal auditor has assisted the organization to reduce/avoid losses generally.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

24. All procedures are properly documented.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

25. There is a strong degree of commonality of procedures across the organization.

Strongly Agree Strongly Disagree

7 6 5 4 3 2 1

Appendix II
Diary of events
And Event Durations

Step 1: a series of preliminary interviews are arranged to gauge the organizational view of culture with both senior and junior members of various organizations.

First Interview: senior executive in mid range financial organization (three hours)

Second Interview: US Navy clerk (two hours)

Third Interview: Officer of RAN (one hour)

Fourth Inteview: Officer of RAN (one hour)

Fifth Interview: Senior Line Manager Transport Organization (one hour)

Sixth Interview: Retired Officer USN (one hour)

Seventh Interview: Line Manager Finance Industry (one hour)

Eighth Interview: Non Executive Director - Listed Transport Company (15 mins)

Ninth Interview: Non Executive Director - Listed Transport Company (15 mins)

Tenth Interview: Non Executive Director - Listed Transport Company (30 mins)

Eleventh Interview: Non Executive Director – Listed Retail Company (10 mins)

Twelfth Interview: Non Executive Director – Listed Retail Company (10 mins)

Thirteenth Interview: Junior Manager Credit Organisation (10 mins)

Fourteenth Interview: Junior Manager Bank (30 mins)

Fifteenth Interview: Junior Manager competitor bank (15 mins)

Sixteenth Interview: Middle Manager credit company (10 mins)

Seventeenth Interview: Junior manager finance company (20 mins)

Step 2: Structured Interview Questionnaire Developed as two questionnaires:

A detailed questionnaire covering the organization generally, this contains:

1. A set of demographic questions of the organization
2. A set of cultural questions designed to identify the organizations culture
3. A set of questions designed to identify the organizational attitude to internal audit and control systems

(for the Internal Audit section only) a second questionnaire designed to identify the unique culture of the internal audit section within the organization. The questions asked about the internal audit section here are identical to the second part of the organizational questionnaire which contains the cultural questions.

These questionnaires are then used to support the following structured interviews:

Step 3. A member of the line management of one organization (Organization 1) is interviewed (two sessions of three hours).

Step 4. A member of the operational internal audit of organization 1 is interviewed (three hours)

Step 5 Minor inconsistencies investigated with line manager of organization 1 (one hour)

Step 6 results confirmed with operational internal auditor of organization 1 (30 mins)

Step 7. A member of the line management of organization 2 is interviewed (two sessions of three hours)

Step 8. A member of the operational internal audit of organization 2 is interviewed (two hours)

Step 9 Inconsistencies within organization 2 confirmed with operational internal auditor (30 mins)

Step 10. A member of the operational internal audit of organization 3 is interviewed (three hours)

Step 11. A member of the line management of organization 3 is interviewed (one hour)

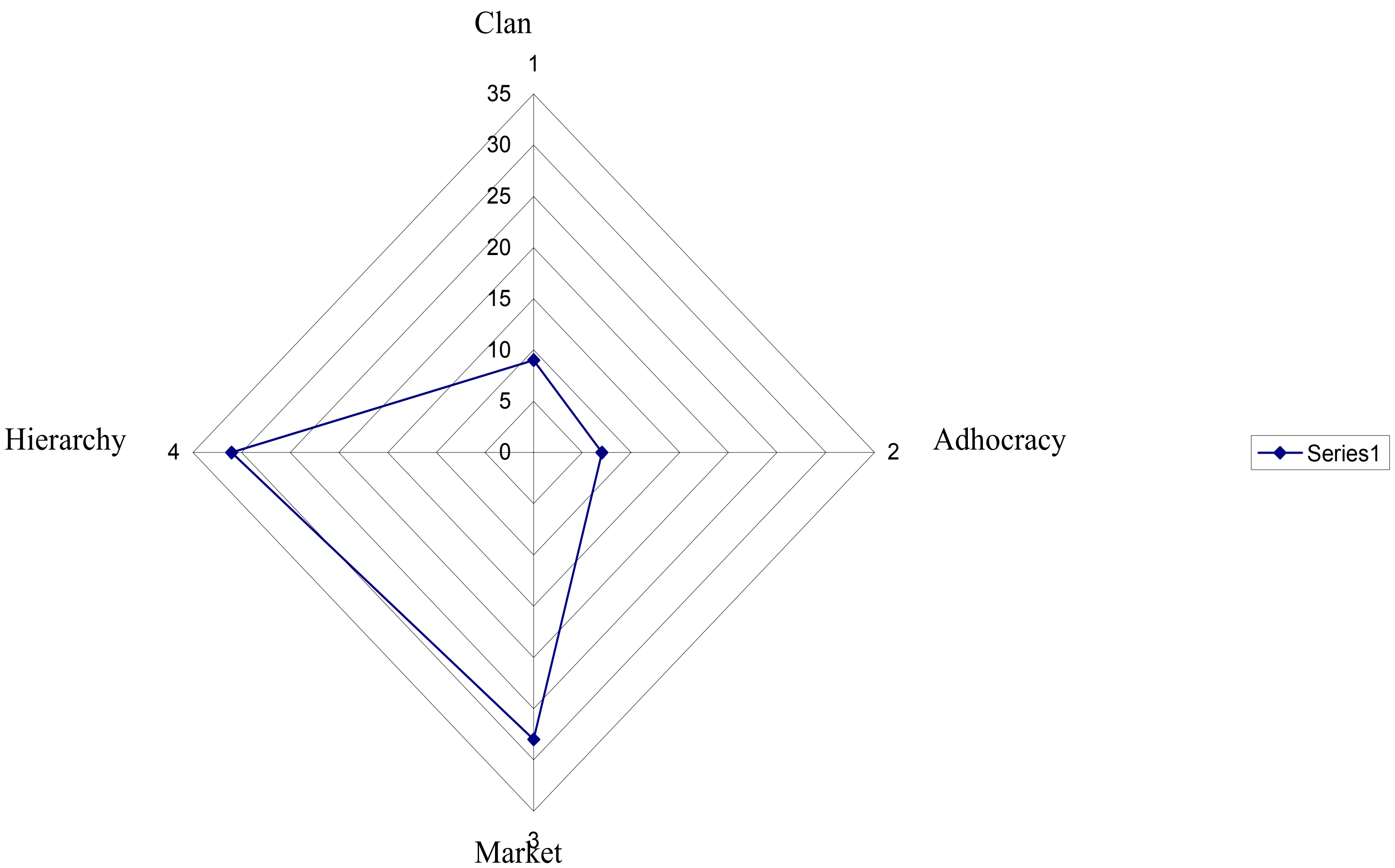
Step 12. Minor inconsistencies investigated with line management of organization 3 (one hour)

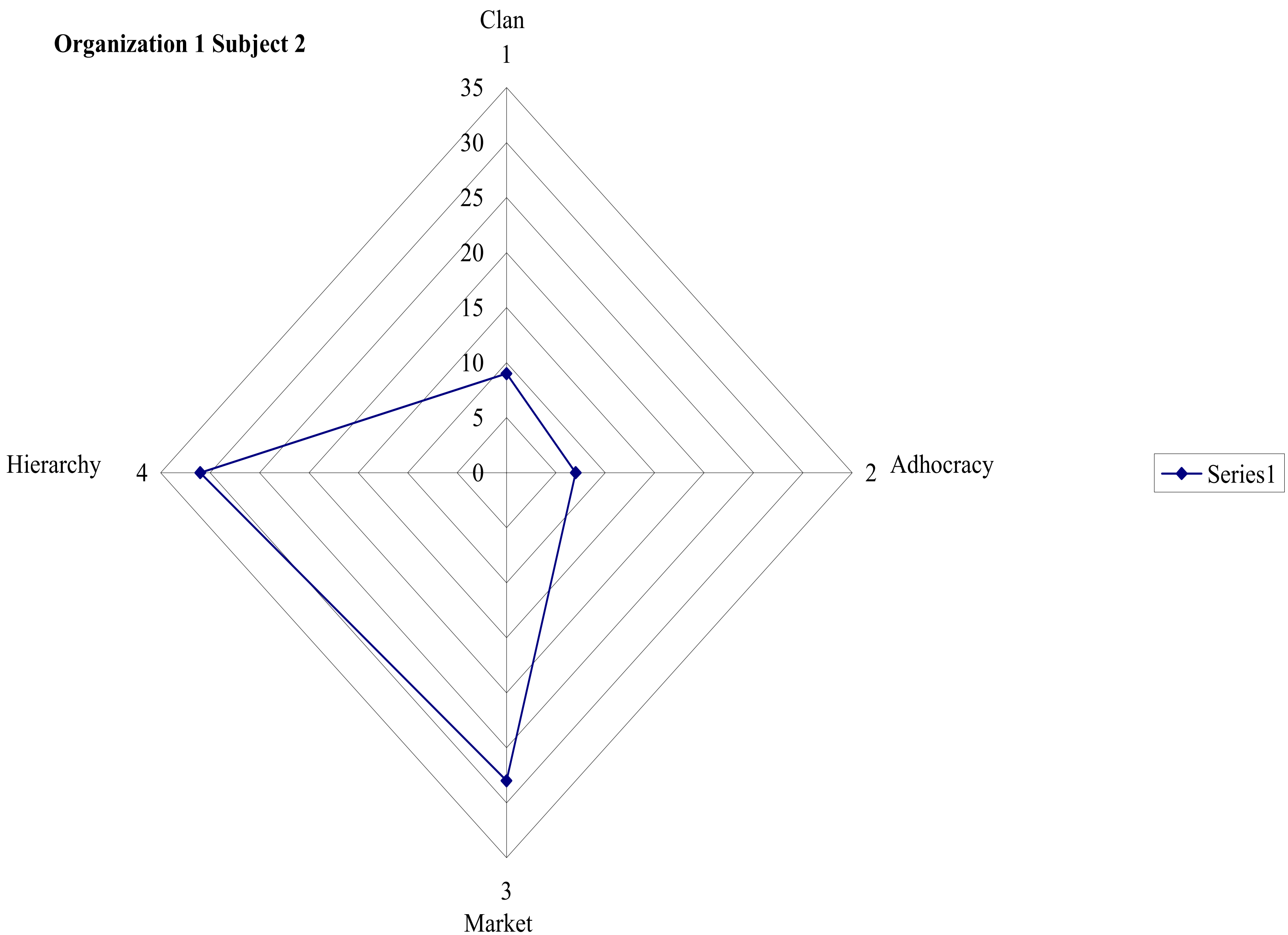
Appendix III

Overlays for Comparison of the Cultures of the Three Organizations

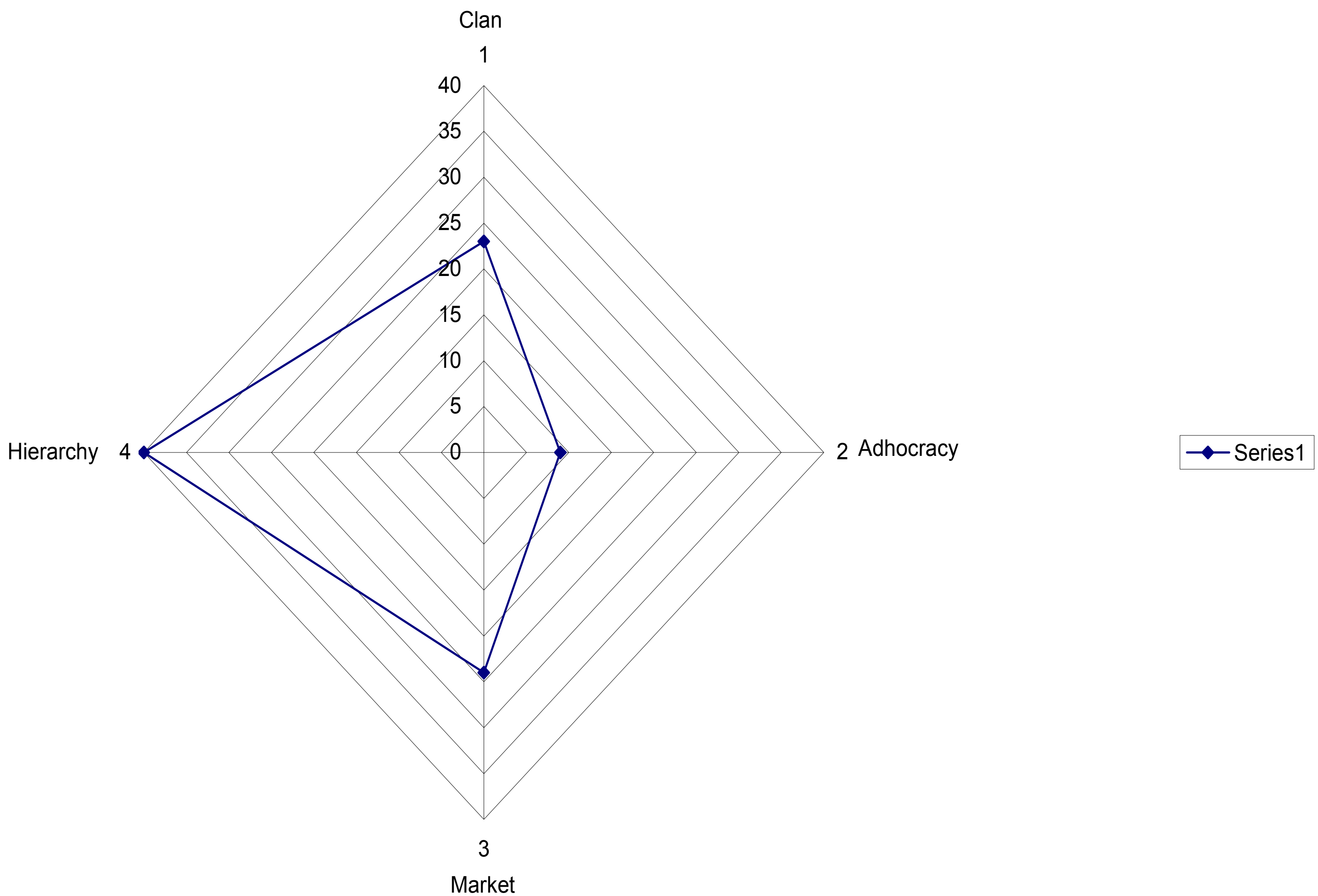
and Their Three Operational Internal Audit sections (Figures 6.1 to 6.9)

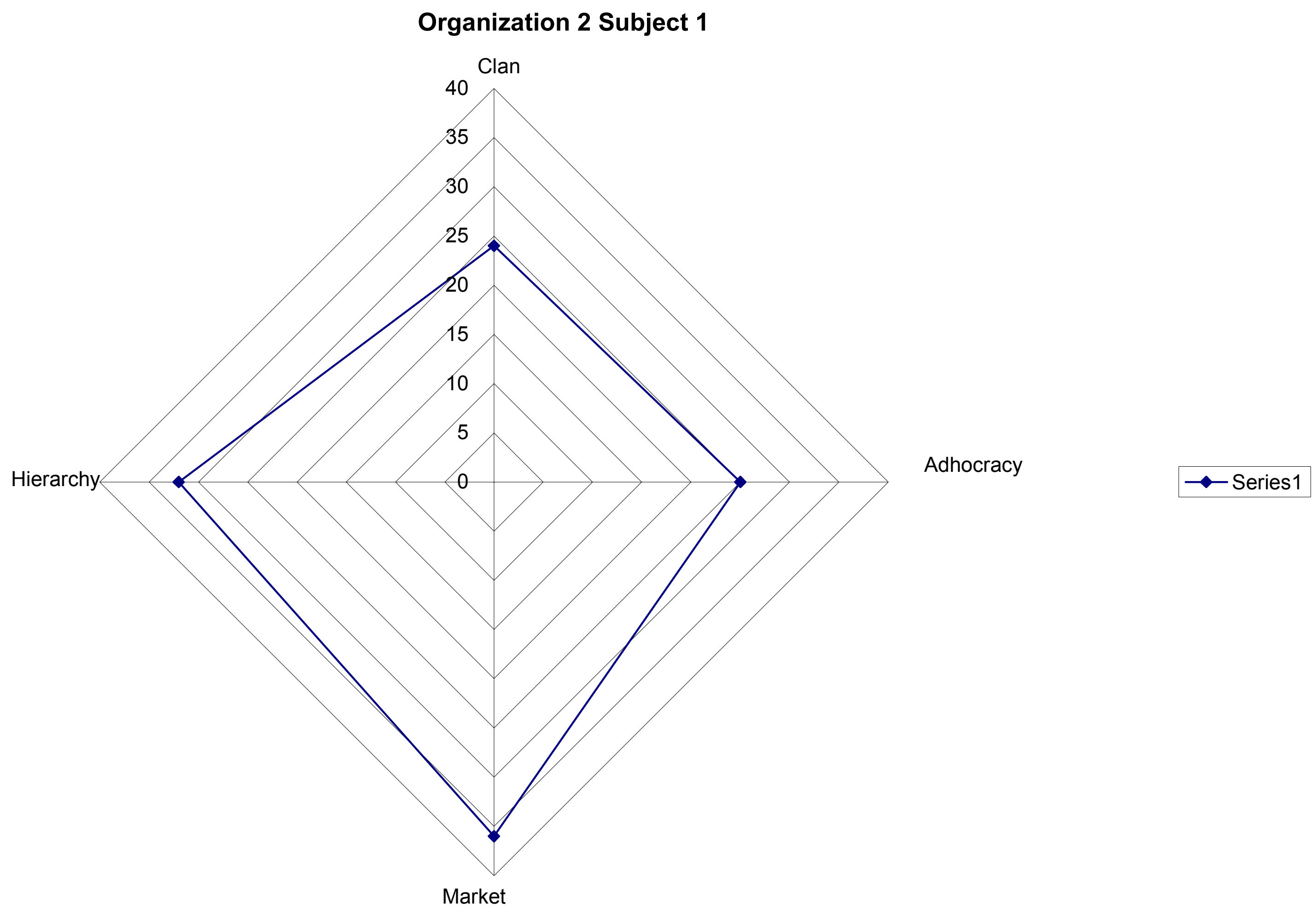
Organization 1 Subject 1



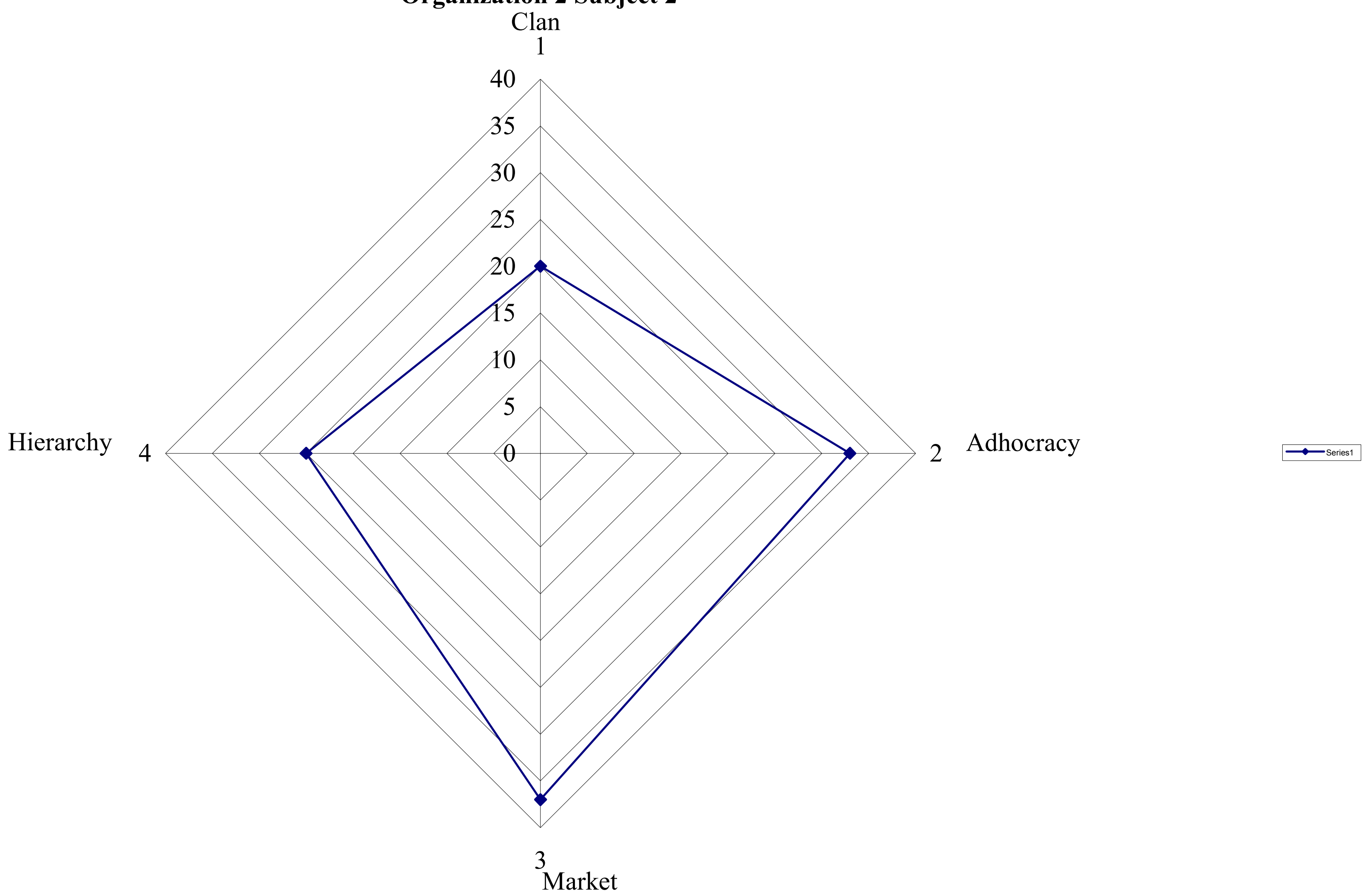

Organization 1 Subject 2
Clan
1
35
30
25
20
15
10
5
0
2 Adhocracy
3
Market
Hierarchy 4
Series1

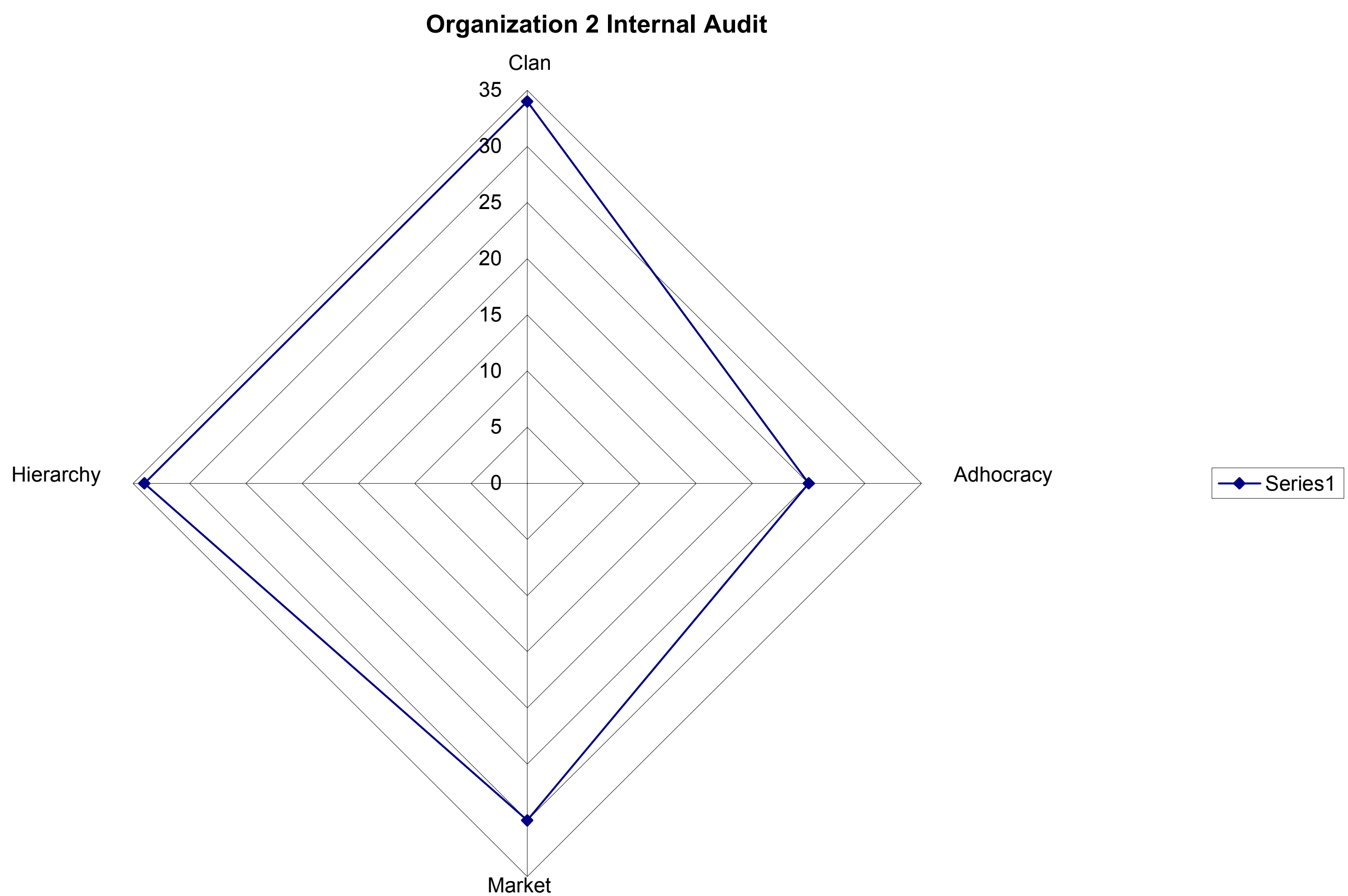
Organization 1's Audit Section




Organization 2 Subject 1
Clan
Adhocracy
Market
Hierarchy
40
35
30
25
20
15
10
5
0
Series1

Organization 2 Subject 2




Organization 2 Internal Audit
Clan
Adhocracy
Market
Hierarchy
35
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20
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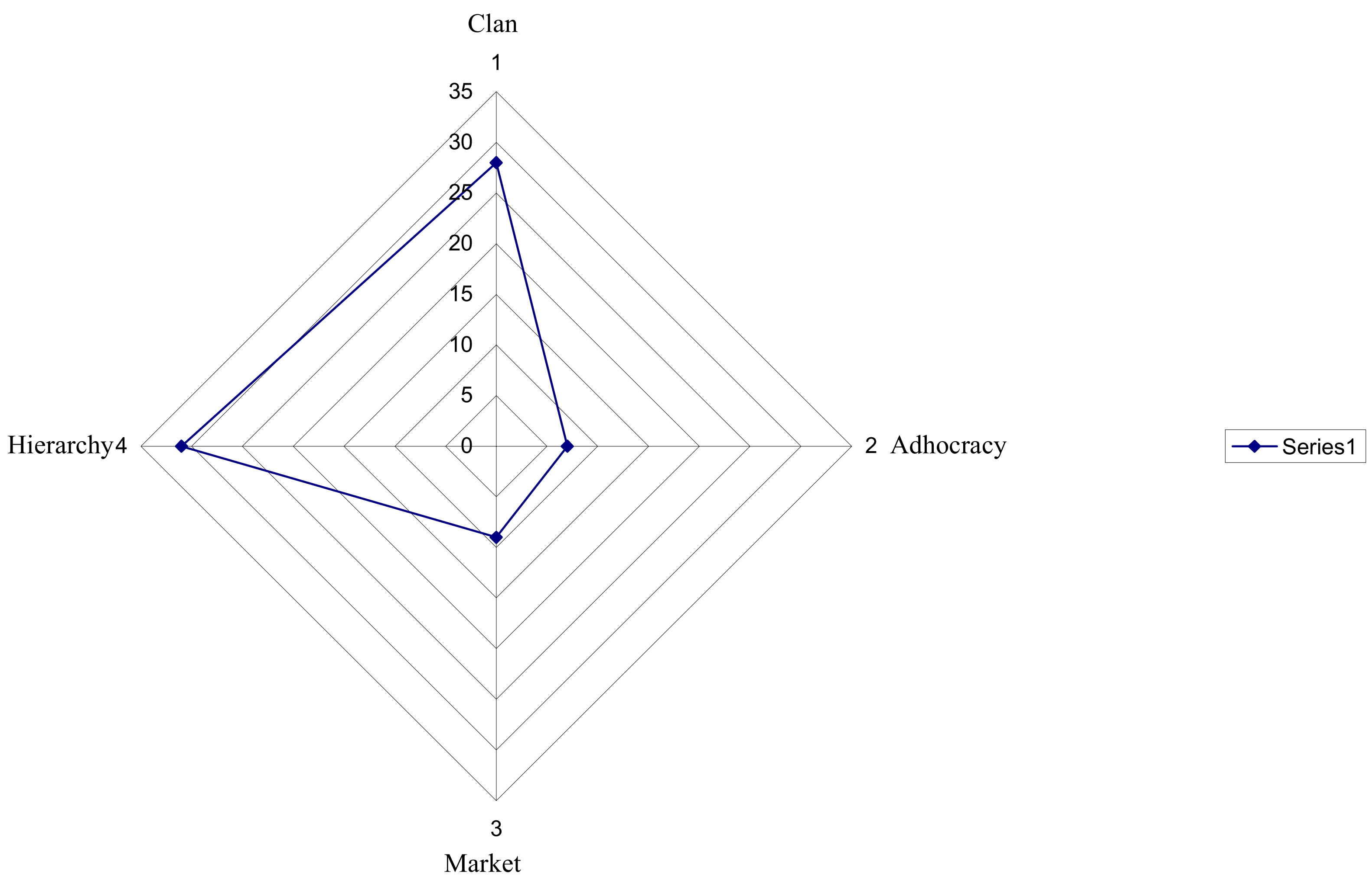
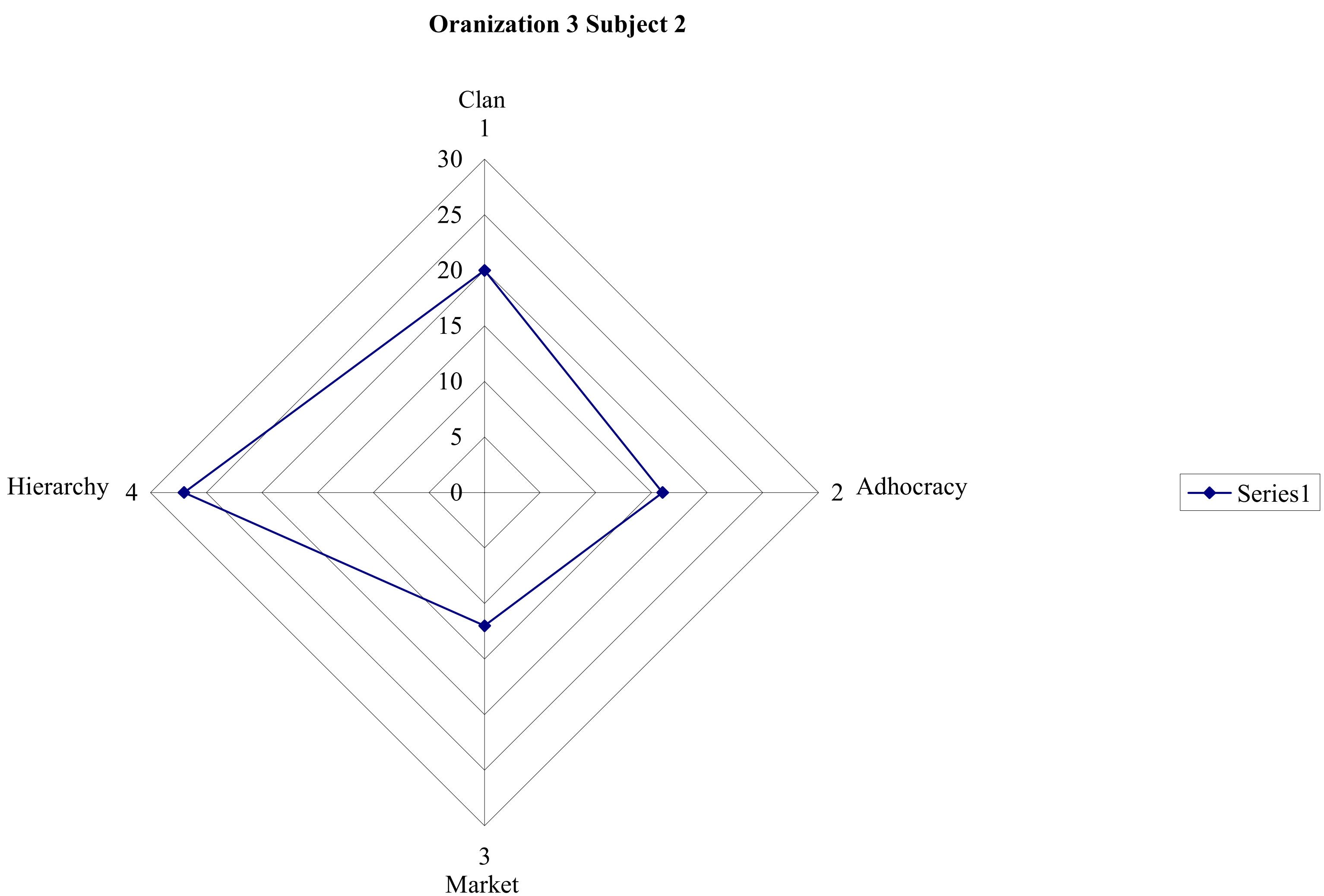
Series1

Organization 3 Subject 1




Oranization 3 Subject 2
Clan
1
30
25
20
15
10
5
0
2 Adhocracy
3
Market
Hierarchy 4
Series1

Organization 3 Internal Audit