

UNIVERSITI TEKNOLOGI MARA

**THE EFFECT OF INDIVIDUAL AND
ENVIRONMENTAL FACTORS ON
INTERNAL AUDITOR'S RISK
JUDGMENT PERFORMANCE**

FAZLIDA BINTI MOHD RAZALI

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ABSTRACT

Since the growing adoption of Risk Based Internal Audit, the value relevance of internal audit profession rests on their ability to audit risk that is substantial to Board of Director and Management. Revelation of high-profile corporate scandal resulted from internal auditor failures has brought the issues of internal auditor's risk judgment quality and objectivity to the forefront and highly scrutinized. As an insider in organization, internal auditor is highly exposed to conflicts which limit their abilities to excel in risk judgment performances. Studies on internal auditor's performance have concentrated on internal audit department performances rather than individual performances. Utilizing Agency Theory, performances are measured based on the effectiveness of the department as monitoring mechanism in shareholder-manager relationship. Nonetheless, previous study tended to omit the need to study on individual internal auditor's performance as an agent to multi-stakeholders which was not well explained by Agency Theory. Hence, based on Social Cognitive Theory and Bonner's (2008) Judgment and Decision-Making Framework, this thesis addresses this gap by considering the combination effects of individual and environmental factors on internal auditor's risk judgment performance of two task scenarios; easy and difficult. The purpose of this thesis is to answer the question as to what extent does individual factors (experience, conflict management style, internal locus of control, external locus of control and self-efficacy) and environmental factors (external auditor engagement quality, external auditor reliance and social pressure) affect internal auditor's risk judgment performances. In addition, the determinant of self-efficacy as well as the mediating effect of self-efficacy on risk judgment performances is also scrutinized in this thesis. Based on purposive sampling, data were collected through a survey questionnaire sent to six hundred internal auditors from public and private sectors organizations located around Wilayah Persekutuan, Selangor, and Wilayah Persekutuan Putrajaya. A total of two hundred sixty-six internal auditors from public and private sectors participated in the survey. Overall, results of this thesis through the analysis of Structural Equation Model confirmed the effect of experience, self-efficacy and social pressure in risk judgment performances of easy task. Meanwhile, other factors were found to affect internal auditor's risk judgment performances of difficult task. Self-efficacy was found to have mediating effect on risk judgment performances in both easy and difficult tasks. The findings reported in this thesis would be very useful to those in internal auditing profession in the effort to improve the credibility and viability of internal audit profession.

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CHAPTER ONE

INTRODUCTION

1.1 Overview

Rapid changes in today's business environment and the associated risks demand internal auditor to improve risk judgment in order to satisfy multi-stakeholder's need (Leech, 2017). As an agent to multi-stakeholders, internal auditor's risk judgment is highly relied by the Board of Directors, Audit Committees, management and external auditor to form their judgment on critical business decision. To create value, internal auditors is expected to have an ability to form judgment on risk that matters to the boards and management (Leech, 2017; Marks, 2017; Seago, 2015). However, there is growing criticism on individual internal auditor's ability to consistently apply risk judgment (Chambers, 2017; Leech, 2017), hence increase stakeholders' dissatisfaction and doubt on the value that internal auditors and internal auditing could bring to the organization (Chambers, 2015a; Roussy & Brivot, 2016). Ultimately, establishing performance measure on internal auditor's risk judgment could align stakeholder's expectation on value relevance of internal audit profession.

In the context of academic research, the area of audit judgment performance emerged over the past 50 years and has grown remarkably since then (Trotman, Tan, & Ang, 2011). Generally, the main research aim to solve the issue regarding the quality of auditor's judgment, in which focused on the measurement of individual or group's judgment performance and exploration of the determinants of judgment performance (Mala & Chand, 2015). Accordingly, internal auditor's failure to assess the existence of fraud risk and irregularities in the organization (i.e. the case of Toshiba and Silver Bird Berhad) signal an issue regarding the quality of internal auditor's risk judgment performance. Low quality of risk judgment performance is the outcome of flaws (i.e. inaccurate, inconsistent and lack of consensus) in internal auditor's risk judgment, which warrant further investigation.

As an insider in an organization, internal auditors is exposed to the situation, action or relationship that could expose them to conflict which limit his or her ability to make an objective judgment on risk (Chambers, 2015b; Jameson, 2011). In the internal audit environment, conflict are vulnerable due to three main caused which is a) dual