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EXPLORING THE RELATIONSHIP AMONG SUSPENSION OF
JUDGEMENT, SEARCH FOR KNOWLEDGE, INTERPERSONAL
UNDERSTANDING, ETHICAL LEADERSHIP AND INTERNAL AUDIT
EFFECTIVENESS

Amad Rashid¹, Basariah Sali^{2}, Halimah Nasibah Ahmad³*

^{1,2,3} Tunku Puteri Intan Safinaz School of Accountancy, Universiti Utara Malaysia. Malaysia

¹amadrashid@gmail.com, ²basa1189@uum.edu.my, ³halimahmad@uum.edu.my

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ABSTRACT

The main objective of the present study is to assess the relationship among suspension of judgement (SJ), search for knowledge (SK), interpersonal understanding (IU), ethical leadership (EL) and internal audit effectiveness (IAE). For this purpose, the present study was conducted in the companies listed in Pakistan Stock Exchange. Two sets of questionnaires were distributed in 400 listed companies, whereas 162 completed sets in all respects with a response rate of 41% were received back. For the analysis of gathered data, PLS-3 was used as the tool. The results of the present study show that SJ, SK and EL have a positive relationship with IAE. This study fills the gap of limited studies conducted regarding audit issues, in the context of Pakistan.

INTRODUCTION

The prime role of the internal audit (IA) function is to offer an independent assurance service on an organization's internal control process, governance and risk management (CIIA, 2018). Though there might seem to be an overlap in the work of the external and internal auditors, the scope of the internal auditors is much broader. While the external auditors only provide an opinion on the quality of the financial statements, the internal auditor's scope extends beyond financial risks. The horizon of the IA work includes issues related to the growth, reputation, impact on the environment and the organization's treatment of its employees (CIIA, 2018). In a nutshell, the internal auditors assist organizations in achieving their goals and objectives through assurance and consulting. The assurance part requires the internal auditors to evaluate the current control systems in place and provide feedback to the managers on the health of these systems. Whereas, the consulting part requires the internal auditor to suggest mechanisms to improve the effectiveness of these systems where necessary.

Owing to the recent financial scandals and corporate collapses, considerable research has devoted to the advancement of IA function (Alzeban & Gwilliam, 2014; Arena & Azzone, 2009; Cohen & Sayag, 2010; Mihret & Yismaw, 2007). An efficient IA function provides benefits to almost every stakeholder and is a critical component of strong corporate governance (Lenz & Hahn, 2015). According to a survey conducted by KPMG on 750 fraudsters worldwide, weak internal controls are the major determinant of financial fraud which contributes to almost 61 percent of fraudulent corporate activities (KPMG, 2016). According to the Corruption Perception Index (2019), Pakistan was ranked 120th amongst the 180 countries surveyed in 2019. The level of prevailing corruption indicates the essence of the effectiveness of the IA function in monitoring and implementation of the internal control systems. Therefore, this study is conducted to assess the relationship among SK, IU, SJ, EL and IAE.

LITERATURE REVIEW

Internal Audit Effectiveness

The need for internal and external auditors is based on the need for independent verification to reduce asset misappropriation, fraud and bookkeeping errors within business organizations. The presence of auditing can be traced back to financial systems of the Roman Empire, the city-states of Italy, Greece, Babylonia, etc., which had thorough procedures of verifications embedded in their systems (Ramamoorti, 2003). However, throughout history fraud cases emerged such as the Tulip scandal and the South Sea Bubble in the 18th century highlighting the need for more systems of internal control over managers.

As the scope of businesses expanded in size and complexity and the European accounting and auditing systems introduced to the United States, the need for a separate internal assurance function that would ensure accurate information to the decision-makers was imminent. By the end of the nineteenth century, the IA function came into being, and the function was responsible for “careful collection and interpretive reporting of selected business facts” to allow managers to keep track of business transactions (Mautz, 1964). Over and beyond the assessment of the financial statement, large corporations have long recognized the value of IA feature for accurate non-financial data operating reports such as: “short supply quantities of components, compliance with schedules, and product quality” (Whittington & Pany, 1998). The IA function began as an internal business function concentrating primarily on defending against wage theft, cash loss and company assets, while gradually expanding its role in the evaluation of almost all financial transactions. As Cashin, Neuwirth, and Levy (1986) have defined, the function evolved from "audit for management " to the "audit of management" approach.

The IIA (2020) now defines IA as:

“Internal auditing is 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.”

While defining IA, the definition above indicates two main aspects of the role of auditing in corporate governance today. Firstly, the IA function is independent of the management. Secondly, the IA provides a control

mechanism to overview the activities of management. The definition also highlights the role of IA in the risk management of the organization where the IA is expected to increase the effectiveness of the risk management process. The definition identifies consulting and assurance activities as the main aim of the IA function.

The new definition focuses on the improvement of operations of an organization by contributing to the improvement of the organization's risk management, governance and controls. Hence the new definition provides the basis of change in the focus of the function to a value addition one. Therefore, the new role of the auditors is to add value and provide consulting services to the management. While exploring the antecedents of internal audit effectiveness, prior academic literature related to the antecedents of internal audit effectiveness is mainly divided into two strands. The first strand relates internal audit effectiveness with internal auditor characteristics including objectivity, effective communication, proficiency, professional care, training and development, work performance, independence and relationship between internal and external auditors (Ahmad, 2015; Alzeban & Gwilliam, 2014; Endaya & Hanefah, 2013; Mihret & Yismaw, 2007).

The second strand discusses the organizational factors such as organization profile, organizational policies, the budgetary status of the internal audit department, departmental characteristics, internal audit department size, internal audit department competence, level of interaction between internal auditors and audit committee, organizational type, risk exposure, organizational size and senior management support (Ahmad, 2015; Alzeban & Gwilliam, 2014; Arena & Azzone, 2009; Endaya & Hanefah, 2013; Mihret, James, & Mula, 2010; Mihret & Yismaw, 2007).

Suspension of Judgement: Relationship with Internal Audit effectiveness

One characteristic of professional skepticism is the feature of withholding judgement until there is a substantial amount of evidence to conclude their views. Statement of Auditing Standards No.1 (AICPA, 1997) emphasis that necessary professional care in the performance of work is required and recommends that before concluding a judgement necessary persuasive evidence should be in place. In AU 230.9 it is again emphasized that the auditor should not content himself with less than compelling facts. According to the standards, professional skepticism makes it essential to gather and evaluate the necessary evidence throughout the audit which reflects that the judgments can be delayed till the necessary evidence has been obtained. Mautz and Sharaf (1961) highlight that the auditor must conclude after evaluating the necessary evidence. Some recent studies have explored the impact of SJ when forecasting audit performance and have revealed that a heavy suspension of opinion has a positive effect on audit efficiency. Ciołek (2017), for example, attempted to examine the role of the suspension in audit efficiency and concluded that the suspension of assessment, along with the other considerations, has a positive impact on the audit effectiveness and improves the auditor's ability to detect fraud. Similarly, another study carried out by Agarwalla, Desai, and Tripathy (2017) has postulated a major role to play in describing audit effectiveness because of SJ as a part of professional skepticism.

Search for Knowledge: Relationship with Internal Audit effectiveness

SK denotes a sense that serves as a tool for an auditor to look for more knowledge for the clarification of the challenging situations (Royae, Nezhad, & Azinfar, 2013). It can be regarded as another characteristic that has a direct connection with the earlier one. Suspending judgement asserts the SK via a collection of evidence aimed at accomplishing the in-depth know-how of things. SK might appear to overlap with a questioning mind however these two are fundamentally different. While the questioning mind has a sense of incredulity, but the search of knowledge has an element of curiosity where the skeptic might be merely interested in gathering knowledge and information regarding the issue at hand rather than just motivated to obtain specific information or to verify a specific conclusion. This element of professional skepticism is quite acknowledged in philosophy. Skeptics are characterized by (Johnson, 1978) people who gain knowledge for the sake of acquiring knowledge only, while Bunge (1991) argues that skepticism instigates an urge for investigation. Likewise, as indicated by Mautz and Sharaf (1961) auditing instills inquisitiveness and forces auditors to conduct audit with an eye of inquisitiveness.

The SK indicates a meaning which is used by an auditor to find more knowledge to challenging situations (Royae, Nezhad, & Azinfar, 2013). It can be viewed as another function that is directly related to the previous one. The suspended judgment affirms that information is sought through the proof compilation to obtain comprehensive know-how.

Research conducted by Ciołek (2017) in analogous ways to test the ability of the auditor to detect fraud through audit performance. The study findings showed that the SK is the key aspect that the successful audit effectiveness can probably be predicted by professional skepticism. The other argues that SK should be considered a key to high-quality audit efficiency. However, past literature (Ciołek, 2017; Pramana & Irianto, 2016; Sarah Mary, Cheot, Chin, Lee, and Tong, 2018) indicates a substantial impact on the audit effectiveness of study for the attributes of the information.

Interpersonal Understanding: Relationship with Internal Audit effectiveness

The initial attributes discussed above are more linked to how the auditors evaluate the evidence. However, one key aspect concerning the evaluation of audit evidence is IU. It is key in determining the motivation or integrity of the personnel who are the source of evidence. SAS NO 99 as stated by Skousen, Smith, and Wright (2009) explicitly urges the auditors to look for incentives and opportunities that may be available to client personnel in case of committing fraud or presenting misleading evidence. The standard also recommends anticipating the possibility of untruthful communication (Hurtt, 2010).

IU denotes to acceptance of integrity and motivation of information providers (Hurtt, 2010). Additionally, Adnan and Kiswanto (2017) in their study investigated the influence of IU on the fraud detection ability of an auditor and reported a positive association between IU and auditors' fraud detection ability. On the other hand, a study also examined the impact of IU and auditor's effectiveness to detect fraud risk, results from the study showed a positive correlation between IU and the auditor's effectiveness to detect fraud risk (McAllister, Blay, & Kadous, 2016). Moreover, Pramana and Irianto (2016) by investigating the association between IU and fraud detection effectiveness put forward that auditors are more effective to detect fraud with effective IU.

Carpenter and Reimers (2013) further indicated that IU is positively associated with the audit effectiveness of auditors for fraud detection. They also highlight that a partner's focus on professional skepticism is important for the efficient and effective detection of risk relevant to fraud and to choose relevant auditing procedures. Highly skeptical auditors tend to ask for more information in presence of potential fraud in an organization (Fullerton & Durtschi, 2004). Therefore, it is concluded that IU has a positive relationship with auditors' fraud detection.

Carpenter and Reimers (2013) also suggested a positive correlation between IU and audit effectiveness of fraud detection. They also stress that a partner stresses professional skepticism to recognize risks that are important to fraud efficiently and effectively and to select relevant audit procedures. Extremely suspicious auditors prefer to ask for more detail in the event of suspicion (Fullerton & Durtschi, 2004).

Ethical Leadership: Relationship with Internal Audit effectiveness

The influence of a leader on the subordinates and the employees of the organization has been the subject of various researches. Many leadership theories are used to explain the influence of leaders on the members of the organization. Among all the dimensions that are taken in these theories (transformational leadership by Burns (1978), charismatic leadership by Conger and Kanungo (1987), authentic leadership by Avolio, Gardner, Walumbwa, Luthans, and May (2004) and spiritual leadership by Fry (2003)) one dimension seems to be common, which is the ethical dimension. At the same time, all these theories consisted of a dimension on ethics but did not have a focus on ethics rather on other dimensions. However, Trevino, Brown, and Hartman (2003) were interested in a single dimension that focused on the ethics of the leader. For this purpose, a qualitative study was conducted and 20 of the current or recently retired top executives of the American companies were interviewed. Twenty ethics officers were also interviewed. The study aimed to find out how the perceptions of top executives and the lower ranks differ concerning EL. The interviewees were asked to think of an executive that they perceived ethical and then answer questions like, how do they define EL, what is the ethical leader motivated by, what are the key characteristics of an ethical leader, how do ethical leaders behave and what are the visions of an ethical leader with regards to the organization. The results indicated that five characteristics are most consistent with EL. Respect and concern for the employees is one of the most prevalent characteristic and ethical leaders are people-oriented who care about people and their wellbeing. Secondly, the importance of visible ethical actions is of utmost importance as ethical leaders are role models and their ethical talk is expected to be backed up by display of ethical behaviour. Third, ethical leaders not only ethically conduct themselves but set standards for the rest to follow. Ethical leaders are not just expected to set standards but to enforce them, that rewards the acceptable and punish the deviant. Fourth, broad ethical awareness from ethical leaders was expected by most of the interviewees. The interviewees believed that ethical leaders do worry about the bottom-line interests, but they show concern on how these bottom-line interests were achieved and all the parties involved have been taken care of in the process. Lastly, the importance of transparency in the decision-making process is equally important and ethical leaders are concerned about the decisions they make and how are they communicated to the rest. Hence these characteristics make EL

content much more comprehensive as compared to dimensions related to ethics in other leadership theories mentioned above.

Brown & Mitchell (2010) argued that realizing the significance of motivating and trusting in the employees’ abilities to accomplish their role to the best of their abilities, ethical leaders enhance employee performance. Brown, Trevino, and Harrison (2005) argued that ethical leaders, in particular focus on developing the full potential of their followers and bring the best out of them. Hence such a treatment by the ethical leaders motivates the employees to perform better to reciprocate an ethical leader (Blau, 1964).

Ethical leaders focus on creating an environment where the subordinates feel psychologically safe and trust relationship flourishes between the subordinates and the leaders. Prior studies (Dirks & Ferrin 2001, 2002; Mayer & Gavin 2005) found that subordinates’ performance is influenced if they trust the leaders. As trust encourages the subordinates to highlight issues and actively engage in proposing solutions for organisational improvement. However, such a trust environment is only possible if ethical leaders demonstrate honest, supportive and fair treatment with their employees (Caldwell & Dixon 2009). Bandura (1977) argues that leaders are perceived role models and influence follower’s performance.

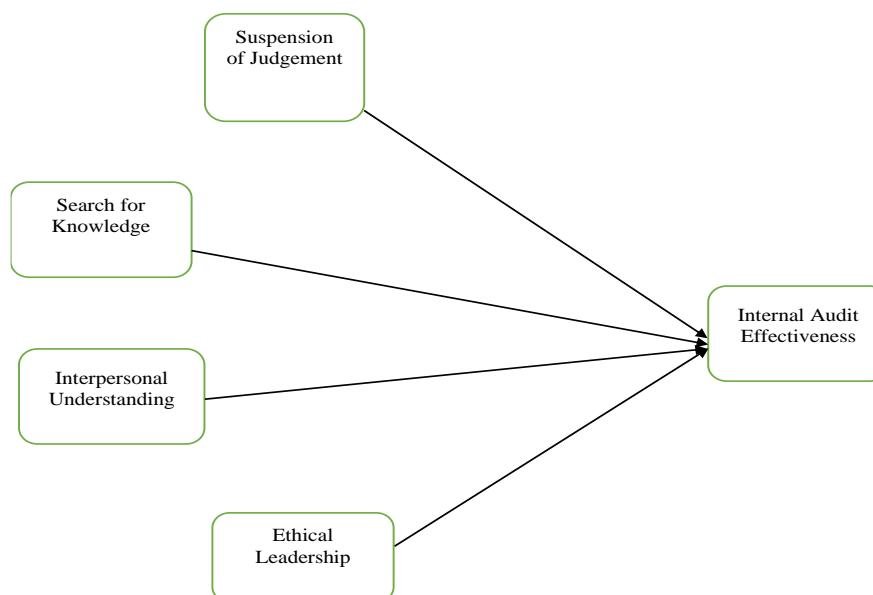
Based on the above discussion, the following hypothesis are developed

H1: There is a positive relationship between the SJ and IAE.

H2: There is a positive relationship between SK and IAE.

H3: There is a positive relationship between the IU and IAE.

H4: There is a positive relationship between the perception of EL in the firm and IAE



METHODOLOGY

This study is designed to investigate the relationships between independent variables SJ, SK, IU and EL to a dependent variable IAE. The unit of analysis for this study is organizational (public listed companies in PSX). Two sets of questionnaires were distributed. One to measure the dependent variable IAE to be filled by the general managers of the company. The first questionnaire

consisted of two sections, the first section covered the demographic information regarding qualification, gender, experience. Whereas the second section contained questions related to the IAE.

The second set of questionnaires was developed to cover the independent variables, addressed to the chief internal auditors of the listed companies. The questionnaire is divided into two sections. Where the first section covers the demographic information regarding qualification, age, gender, experience, position. The second and concluding section obtains information about SJ, SK, IU, and EL. A total of 400 questionnaires were distributed among the respondents out of which 162 were received back. PLS SEM was used to analyse the effects of the main constructs.

RESULTS AND ANALYSIS

As mentioned above, PLS-SEM was used for the analysis of the data gathered. For this purpose, smart PLS-3 was used as the tool in the present study. Analysis through PLS is divided into two parts. The first part is the measurement model. In this section convergent validity, and discriminant validity are discussed.

Convergent validity refers to the degree to which the interested measure of the study is related to the rest of the shared measures in the construct (Petter & McLean, 2009). In other words, convergent validity refers to the establishment of an efficient relationship between under reviewed scales and the validated scales that are believed to measure the constructs (Dmitrienko, Chuang-Stein, & D'Agostino, 2007; Petter & McLean, 2009). Moreover, Average Variance Extracted (AVE) is suggested to measure the convergent validity of the constructs with its threshold value of at least 0.50 or above (Fornell & Larcker, 1981; Hair et al., 2011; Vinzi, Chin, et al., 2010). To assess the convergent validity in the present study, factor loading, AVE, composite reliability and Cronbach Alpha are calculated in the present study.

In consistence with PLS-SEM, the current study has assessed the individual item reliability through measuring outer loadings of each construct (Hair Jr et al., 2014). Moreover, Hair et al. (2011) proposed to retain the items having values 0.70 or above, otherwise delete the items scoring less than 0.70 values. On the contrary, Henseler, Ringle, and Sinkovics (2009) recommended a cut-off point of 0.40; and argued that any items having a score of less than 0.40 must be removed from the measurement model. In a similar vein, Hair Jr et al. (2014) argued that “ indicators with outer loadings between 0.40 and 0.70 should be considered for removal from the scale only when deleting the indicator leads to an increase in the composite reliability or the average variance extracted”. Thus, the present study has fulfilled the criteria mentioned by Hair et al. (2014).

	Ethical Leadership	Internal Audit effectiveness	Interpersonal Understanding	Search for knowledge	Suspension of Judgment
EL1	0.749				
EL10	0.747				
EL2	0.673				
EL3	0.612				

	Ethical Leadership	Internal Audit effectiveness	Interpersonal Understanding	Search for knowledge	Suspension of Judgment
EL4	0.729				
EL5	0.714				
EL6	0.760				
EL7	0.757				
EL8	0.778				
EL9	0.724				
IAE1		0.791			
IAE10		0.752			
IAE11		0.728			
IAE12		0.747			
IAE13		0.745			
IAE14		0.715			
IAE15		0.611			
IAE2		0.785			
IAE3		0.767			
IAE4		0.788			
IAE5		0.793			
IAE6		0.810			
IAE7		0.786			
IAE8		0.755			
IAE9		0.737			
IU1			0.603		
IU2			0.840		
IU3			0.845		
IU4			0.851		
IU5			0.742		
SJ1					0.823
SJ2					0.830
SJ3					0.813
SJ4					0.839
SJ5					0.701
SK1				0.761	
SK2				0.625	
SK3				0.858	
SK4				0.823	
SK5				0.823	
SK6				0.729	

The next phase is to assess the internal consistency reliability. Internal consistency reliability refers to the extent to which all of the particular scales are capable of measuring the same concept (Bijttebier et al., 2000; Sun et al., 2007). Composite reliability and Cronbach alpha are widely used to assess internal consistency reliability (Bacon, Sauer, & Young, 1995; McCrae, Kurtz, Yamagata, & Terracciano, 2011).

Moreover, the current study examined convergent validity through average variance extracted (AVE) of each latent construct (Henseler et al., 2009 & Hair et al., 2012). AVE is computed as the means of variance extracted for the item loading on a construct. As per Hair et al. (2012) and Henseler et al. (2009), the recommended threshold value of AVE is 0.50 and above.

	Cronbach's Alpha	Composite Reliability	Average Variance Extracted (AVE)
Ethical Leadership	0.900	0.917	0.527
Internal Audit effectiveness	0.946	0.952	0.571
Interpersonal Understanding	0.837	0.886	0.612
Search for knowledge	0.865	0.899	0.599
Suspension of Judgement	0.861	0.900	0.645

Discriminate validity refers to the degree of variations between constructs. In other words, it can be referred to as the degree of variations between all the latent constructs (Duarte & Raposo, 2010). Consequently, Hair et al. (2013) confirmed the Fornell-Larcker criterion as the most convenient approach for the measurement of discriminate validity.

Discriminant Validity

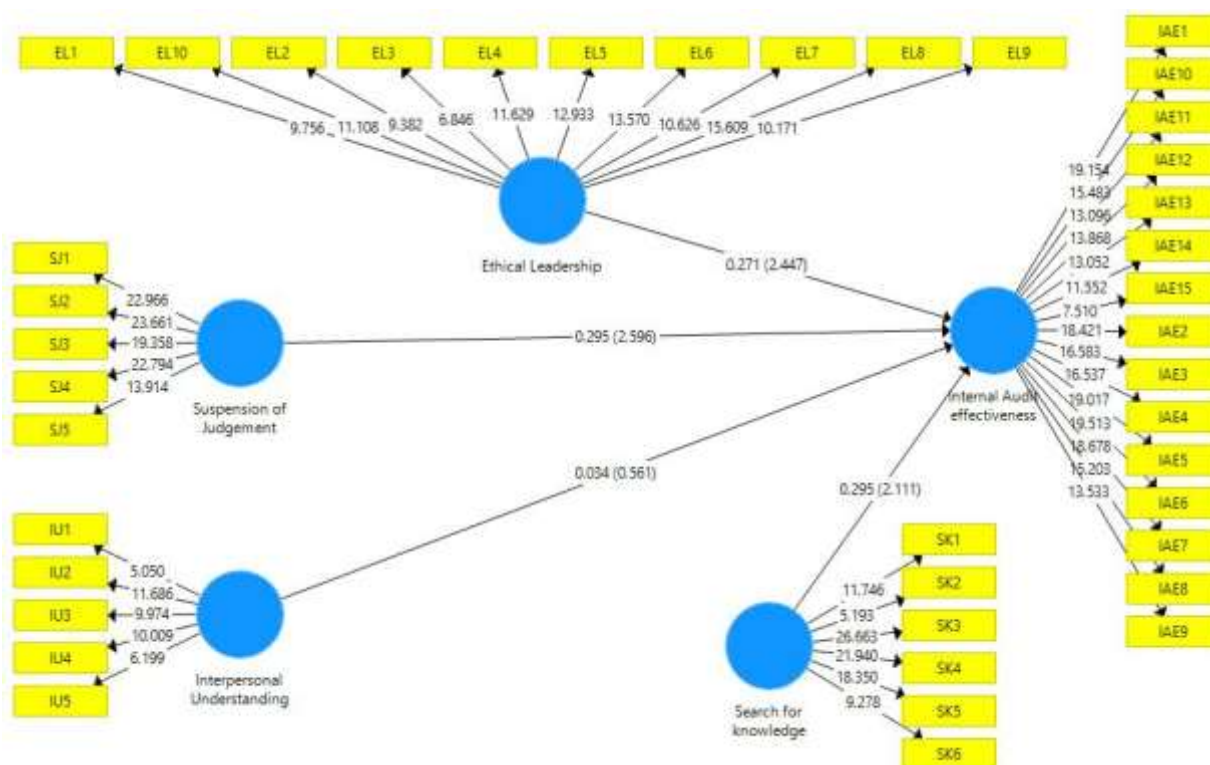
	Ethical Leadership	Internal Audit effectiveness	Interpersonal Understanding	Search for knowledge	Suspension of Judgement
Ethical Leadership	0.726				
Internal Audit effectiveness	0.614	0.756			
Interpersonal Understanding	0.244	0.261	0.782		
Search for knowledge	0.751	0.620	0.271	0.774	
Suspension of Judgement	0.384	0.520	0.271	0.377	0.803

After assessment of the measurement model, this study has assessed the structural model in which the already proposed hypotheses are tested. For this purpose, the bootstrapping procedure was adopted (Basheer et al., 2019;

Basheer et al., 2021; Nuseir et al., 2020; Yan et al., 2020). Where the contribution of each exogenous variable is stated in terms of standardized beta values (chin,1998). The present study ran a bootstrap at 5000 bootstrap samples for the 162 responses at a significance level of $p < 0.05$ to test the hypothesis proposed (Hair, Hult, Ringle, & Sarstedt, 2013).

		Beta	SD	T- Value	P Values	Decision
H1	Suspension of Judgement -> Internal Audit effectiveness	0.295	0.114	2.596	0.010	Supported
H2	Search for knowledge -> Internal Audit effectiveness	0.295	0.140	2.111	0.035	Supported
H3	Interpersonal Understanding -> Internal Audit effectiveness	0.034	0.061	0.561	0.575	Not supported
H4	Ethical Leadership -> Internal Audit effectiveness	0.271	0.111	2.447	0.015	Supported

The above table illustrates that there exists a positive relationship between SJ and IAE (Beta= 0.295, T=2.596). Therefore, H1 is supported. Moreover, H2 is also supported because there is also a positive relationship between SK and IAE (Beta= 0.295, t= 2.111). On the contrary, H3 is not supported in present research (Beta= 0.03, t=0.575). In the end, H4 of the present study is supported because EL and IAE are positively associated as well (Beta= 0.271, t=2.447).

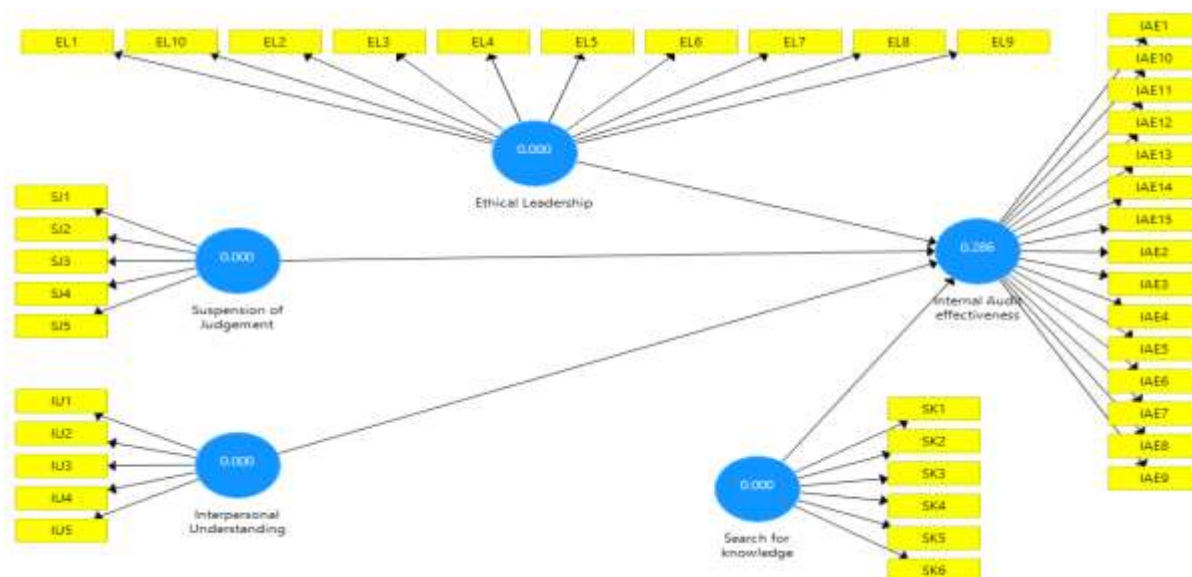


The coefficient of determination R² of the endogenous latent variable is amongst the most adopted criteria for the assessment of the structural model (Hair et al., 2013). Consequently, Cohen (1988) argues that R² values of 0.02, 0.13 and 0.27 designate weak, moderate and substantial R² values.

	R Square
Internal Audit effectiveness	0.512

The study has further examined the predictive relevance (Q²) which is another toll of structural model assessment. This assessment is obtained through the Stone-Geisser test of predictive relevance followed by the blindfolding procedure (Geisser, 1974; Stone, 1974).

	Q² (=1-SSE/SSO)
Internal Audit effectiveness	0.286



DISCUSSION AND CONCLUSION

The results of this relationship show that SJ has a strong positive relationship with IAE. These findings are underpinned by both European and American auditing norms, i.e., ISA 200 and SAS 82, respectively, suggest that the skeptical mind is a mindset that determines most professional skepticism. Many accounting studies compare this notion to concepts such as skepticism, denial, doubt, both of which have certain elements of questioning (Nelson, 2009).

The result of the SK and IAE is also significant in this study. This outcome is in line with the past studies of Fullerton and Durtschi (2004), Pramana and Irianto (2016) and Sayed Hussin et al. (2017) found SK significantly influences auditor’s effectiveness to detect fraud. Hurtt (2010) argued that people with such traits are full of inquisitiveness and seek knowledge not only to verify evidence but also to enjoy the learning process. This result confirms the argument of Mary et al. (2018) who found auditors when faced with complex situations tend to seek additional information.

On the other hand, the results of hypothesis 3 are contrary to the expectations. Interestingly, the results revealed that the relationship between IU and the IAE was found insignificant in this study. The outcome revealed by this study, contrary to the studies of, who claims that IU has a significant influence on the auditor’s effectiveness to detect the possible fraud.

The result of EL of top management on the IAE is significant. These results are aligned with the conception of Webb (2015), who examines the EL as a moderator on the relationship between audit quality and auditor personal traits and concludes that EL enhances audit quality.

The present study has few limitations as well such as self-administered questionnaires were used to collect data from public listed companies in the Pakistan stock exchange. This may influence the truthfulness of the data composed as the questionnaires might not be filled by intended respondents (Hair Jr, Sarstedt, Matthews, & Ringle, 2016). In the end, the findings of the present study can be helpful for the policymakers of auditing in Pakistan and other Asian settings.

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