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The role of internal auditing in risk management

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ABSTRACT

This paper is based on a theoretical analysis of the role of internal auditing in the accountability framework of contemporary corporate governance. We conceptualize the risk management rationale of internal auditing by drawing on the concept of accountability. We locate the emergence of internal auditing within the metamorphosis of capitalism. It is argued that this development produced the institutionalization of structural control of the firm to address the control problem in the inherently conflicting relationships that characterize accountability relations of capitalist enterprises. The exercise of control in this context entails ensuring accountability of employees, management and the board of directors to shareholders to increase profit. The extant literature does not provide an integrated conceptual framework that explains the role of internal auditing with a holistic view of this accountability landscape. This paper explains how the accountability relations of advanced capitalism create conditions that produce the demand for internal auditing as a risk management technology deployed to advance the managerial values of efficiency and effectiveness of the firm through assurance and advisory services.

Keywords: Accountability, Corporate governance; Internal auditing; Risk management

1. Introduction

The role of internal auditing in assisting management and board of directors to manage risk (Institute of Internal Auditors, 2004; Sarens & Beelde, 2006; Spira & Page, 2003) and enable them to accomplish corporate objectives (Gramling, Maletta, Schneider, & Church, 2004; Institute of Internal Auditors, 2004; Spira & Page, 2003) has been increasingly recognized. Weaknesses in governance arrangements evidenced by waves of corporate collapse in the early 2000s (Joe Christopher, 2010; Rezaee, 2005; Sikka, 2009) has led to an increased emphasis on internal auditing, which is witnessed by post-Sarbanes Oxley developments in stock exchange regulatory practices (Mihret, James, & Mula, 2010). Nevertheless, despite its rise as an integral component of the corporate governance fabric of contemporary capitalist enterprises (Joseph V Carcello, Dana R. Hermanson, & K. Raghunandan, 2005a; Sarens, De Beelde, & Everaert, 2009), internal auditing remains a neglected area of research (Gendron & Be´dard, 2006) not least because arguments of Agency Theory (Jensen & Meckling, 1976), which remains the dominant theory informing internal audit research (Adams, 1994; Mihret et al., 2010), does not fully explain how internal auditing fits in the multi-layered control framework that connects employees, management, the board of directors and shareholders of the firm (Mihret, 2013).

According to agency theory, the demand for internal auditing arises due to the contractual principal-agent relationship between owners and management of the firm. Each party in this relationship takes steps to protect its interests and to signal that the other party's interests are promoted. The theory explains that internal auditing (and other internal control mechanisms) as voluntarily introduced by management to signal to shareholders that the former is properly discharging the goal of maximizing shareholders' wealth (Jensen & Meckling, 1976). Management also voluntarily seeks external auditing to provide independent assurance on financial reports prepared by management for shareholder's use. Nonetheless, from an internal audit research perspective, this theory suffers from a key epistemological shortcoming emanating from the limitations of the theory's neoclassical economic foundation (Mihret et al., 2010). That is, the arguments of the theory are based on the notion that competitive markets underpin the contracts underlying the agency relationship. This assumption is problematic from internal audit research perspective, because the demand for internal auditing is not market-driven. Unlike external audit reports which serve to address the information asymmetry problem in the context of the firm's relationships with external parties (Healy & Palepu, 2001), internal audit reports are available neither to the market nor shareholders. Thus, an alternative perspective is needed that enables understanding the role of internal auditing by considering a holistic view of the firm's internal and external accountability relations.

Against this background, the concept of accountability is employed to explain the role of internal auditing in the control framework in which contemporary capitalist organizations operate. Accountability is conceptualized as 'entail[ing] a relationship in which people are required to explain and take responsibility for their actions' (Sinclair, 1995, p. 220-221), which in turn involves "the giving and demanding of reasons for conduct" (Roberts & Scapens, 1985, p. 447). In this context, internal auditing is conceptualized as historically constituted along with the historical development of organizational rationalities, the relevant logic of control, the objects of control, and the accountability relations in which controls are embedded. Internal auditing assists management and the board in managing the risk of failure to achieve organizational goals. Risks facing present day society are too complex to manage through insurance aside from not being amenable to statistical prognosis (Aradau & Munster, 2007; Beck, 1992). By building on current thinking that risk management is fundamentally a control problem (Committee of Sponsoring Organisations, 1992; Spira & Page, 2003), the present paper advances the central argument that internal auditing can be viewed as a risk management technology deployed in the multi-layered accountability structure of capitalist organizations. It is argued that internal auditing provides selective visibility to areas that need management intervention to ensure that business activities are executed according to management's conceptions and that management meets the accountability demands of the board and shareholders of the firm.

The remainder of this paper is structured as follows: Section 2 develops the conceptual framework of the paper and the evolution of techniques invoked to address control issues of twentieth century capitalist firms; Section 3 analyzes the role of internal auditing as a risk management technology using insights developed in Section 2; Section 4 presents a discussion, draws implications and concludes the paper.

2. Capitalist accountability and modern management

2.1. Accountability relationships in capitalist firms

The concept of accountability implies “the duty to provide an account (by no means necessarily a financial account) or reckoning of those actions for which one is held responsible” (Gray, Owen, & Adams, 1996, p. 39). As briefly alluded to in the preceding section, accountability ‘entails a relationship in which people are required to explain and take responsibility for their actions’ (Sinclair, 1995, p. 220-221). This relationship involves “the giving and demanding of reasons for conduct” (Roberts & Scapens, 1985, p. 447). In the context of advanced capitalist firms, achieving the required profit goals remains a major accountability concern (Bryer, 2005). Systems of accountability are created to ‘bridge the gap’ between the expected and actual performance of the boards of directors (Huse, 2005, p. S67; Roberts, McNulty, & Stiles, 2005). The board’s accountability relations with shareholders extends to the various levels of management and to employees of the organization (Mihret, 2013). The concept of class underlies the accountability relationship that exists in capitalist enterprises. According to Weber (2012, p. 424), a class ‘is any group of persons occupying the same class status’ where ‘class status’ is:

the typical probability that a given state of (a) provision of goods, (b) external condition of life, and (c) subjective satisfaction of frustration will be possessed by an individual or a group.”. These probabilities define class status in so far as they are dependent on the kind and extent of control or lack of it which the individual has over goods or services and existing possibilities of their exploitation for the attainment of income or receipts within a given economic order.

This class-based nature of the accountability relationship between management and employees of the firm portends the presence of conflict (Bryer, 2005, 2006b). Various managerial strategies including performance-based payment of wages are employed to align the interests of management and employees of the firm with those of shareholders. The achievement of profit goals in this context can be beset by eventuation of risk, which originates, *inter alia*, from the inherent contradiction between the respective interests of shareholders and management as well as management and employees. As a result, a range of intervention mechanisms become necessary to harmonize the efficiency and profitability demands of shareholders on the one hand and the interests of employees for higher wages and better working conditions on the other (Rose, 1990). The late nineteenth and early twentieth century metamorphosis of capitalism in the USA transformed the structure of capitalist organizations into a more complex one through the separation of planning and execution of work. This separation brought about the development of rational management approaches necessary to manage the conflictual labor-management relations. It also facilitated the development of control mechanisms necessary in the absence of direct management supervision of work (Braverman, 1974; Friedman, 1977).

Under this framework of accountability, shareholders own the firm while management directs it as the agent of shareholders. Thus, employees are controlled and monitored by management (Burawoy, 1979, p. 24). Such an accountability relationship entails the formation of a set of institutions “that organize, transform, or repress struggles” among parties in the accountability relationship. Compromise between labor and capital and the rise of collective bargaining that happened in twentieth century capitalism “creates a system of [internal] government [i.e., within the enterprise], ... by helping to reconstruct the managerial process”. This system, in turn, transformed control into a hegemonic form whereby the “industrial citizen” is formed with respective rights and obligations (Burawoy, 1979, p. 110).

Organizations' internal policies and procedures as well as control systems such as accounting (Spira & Page, 2003) serve as the "internal state" for controlling business activities of the firm. These institutions gain relative autonomy from both management and labor and are also inscribed in the employment contract (Burawoy, 1979, p. 116-117). While these control systems serve to enhance accountability in the value creation process (Bryer, 2006a, p. 563-4), they are nevertheless not flawless. Thus, modern society seeks assurance on these controls—a practice which Power (1994, p. 300) refers to as the 'control of control' that is necessary in contemporary 'audit society'. The mode of operation of such institutions makes evident the demand for internal auditing as a monitoring and control technology.

Corporate governance in contemporary capitalist enterprises comprises multiple control levels emanating from the accountability relationships at the board, management and operational levels (Joe Christopher, 2010). By drawing on management control theory (Emmanuel, Otley, & Merchant, 1990), Bryer articulated the concept of social control, which comprises action controls (Bryer, 2005) and results controls (Bryer, 2006a). Results controls refer to the accountability of management to achieve the required profit target (Rob A Bryer, 1999). Achievement of this rate depends on proper action controls through policies as well as the impact of external factors affecting the organization. Burawoy's (1979, 1983) takes such external factors into account in his analysis of organizational controls. The need for results control emanates from the socialization of capital whereby owners of capital collectively establish accountability relations within the firm (Rob A Bryer, 1999). Shareholders are represented by the board of directors as a body that links management and shareholders. Audited financial statements serve as a means of operationalizing accountability of management to shareholders as a body (R. A. Bryer, 1999). Consistent with this concept, the coordination of internal and external audit has received considerable attention especially over the last two decades due to the understanding that robust corporate governance systems help minimize the devastating impact of corporate collapse (Rusak & Johnson, 2007). Recognition of internal audit's role in enhancing financial reporting quality underpins this notion. Consistent with this observation, the Blue Ribbon Committee (1999) report presents audit committees of boards, internal auditing and external audit as a three-legged-stool of corporate governance that enable ensuring reliability of financial reports. The increased focus on internal and external audit to enhance audit committee effectiveness and financial reporting quality (DeZoort, Hermanson, & Houston, 2003), especially following the corporate collapses of the 1990s and 2000s (R. Johnson, 2007), are necessitated by the imperative of increased accountability to shareholders. Internal auditing renders visibility to areas that warrant management attention and recommends the *modus operandi* for addressing risk *ex ante* and evaluating results *ex post*.

2.2. Twentieth century transformation of accountability and management imperatives

Analyzing the transformation of accountability relations in capitalist firms during the twentieth century enables us to understand the conditions that gave rise to the demand for internal auditing and the subsequent establishment of the Institute of Internal Auditors in the USA in 1941 (Ramamoorti, 2003). Friedman (1977) analyzed control of the capitalist enterprises in three phases. He considers the late 1870s to 1914 as the first phase when the rise of managerialism in the form of Taylorism and Gilbreth's motion study along with the increase in size and complexity of business. In the second phase (i.e., from 1914 to 1945) understanding of the limitations of direct control of labor in the earlier phase facilitated the rise of "flow production" that enabled mass production with reduced need for direct supervision of workers. The third phase relates to the post-1945 period when labor union

resistance grew stronger and management started employing the control strategy of “responsible autonomy”.

To understand the emergence of internal auditing as a management technology, it also becomes necessary to closely consider the development of modern management as linked to the development of capitalist accountability relations. Prior to the nineteenth century when hierarchical organizational structures—in which ‘managers managed other managers’—were not practiced, ‘owner-entrepreneurs’ were involved in most of the business activities of enterprises (Johnson & Kaplan, 1987, p. 6, 37). The rise of scientific management (Taylor, 1947) during the late nineteenth and early twentieth century (Johnson & Kaplan, 1987) is regarded as a watershed in the development of modern management of organizations (McKinlay, Carter, Pezet, & Clegg, 2009). While scientific management practices focused on measuring efficiency of individual activities (H. T. Johnson & Kaplan, 1987, p. 52), coordinating diverse activities of multidivisional enterprises such as DuPont Powder Company and General Motors Corporation as well as measuring performance of the entire organization became important issues of the early twentieth century. This development engendered the use of return on investment as a measure of performance, which links performance to capital invested (Johnson & Kaplan, 1987, p. 11, 43, 57). In Johnson and Kaplan’s (1987, p. 65) words, ‘[t]he efficient and effective management of capital itself eventually became a driving force in the firm.’ Such complex multidivisional firms that emerged during the early twentieth century employed internal monitoring and control mechanisms such as ‘internal audit’ (H. T. Johnson & Kaplan, 1987, p. 99) to ensure that managers at various hierarchies are contributing to the achievement of the overall goal of the firm.

The increase in size and complexity of corporations (Johnson & Kaplan, 1987) in the late nineteenth and early twentieth century also produced the separation of management and ownership of capitalist enterprises (Berle & Means, 1932). Such developments in turn created new accountability relationships that produced the demand for internal auditing (Brink, 1947). Control mechanisms including internal auditing become necessary in such a system to fend off the risk of failure to achieve overall organizational goals that may originate from possible loss of control of the complex organization and potential sub-goal pursuit of divisions (H. T. Johnson & Kaplan, 1987). The accounting abuses of the 1920s (Previts & Merino, 1979) and the decline in productivity during the Great Depression (McElvaine, 1993, p. 17) significantly contributed to the emphasis on audited financial statements and increased attention on investor protection as witnessed by the formation of the Securities and Investments Commission in 1934 (McElvaine, 1993; Previts & Merino, 1979). Following the arguments developed earlier in this paper regarding capitalist accountability, the emphasis on investor protection affirms the centrality of management accountability to shareholders, which extends internally through the lower levels of management and employees. By extension, this argument explains the demand for mechanisms of ensuring internal accountability such as internal auditing, which formally emerged as a separate function in organizations.

Thus, the rise of contemporary internal auditing should be understood in the context of the complex organizations of twentieth century capitalism. Thompson (1967, p. 10) conceives of complex organizations of the twentieth century as “open systems, hence indeterminate and faced with uncertainty, but at the same time as subject to criteria of rationality and hence needing determinateness and certainty”. Management metamorphosed in this context as the agent to direct and monitor the firm to advance shareholders’ interest. The increasing

complexity of capitalist enterprises coupled with the expansion of capital necessitates the separation of the conception and execution of business activities, although such separation existed in earlier less complex organizations as well. In management terminology, this is the planning of work and its implementation. Separating the two aspects of work also asserts the division of the 'manager' and 'managed', which in turn produces the antagonistic relation between labor and management (Braverman, 1974, pp. 67-8):

As capitalism creates a society in which no one is presumed to consult anything but self-interest, and as the employment contract between parties sharing nothing but the inability to avoid each other becomes prevalent, management becomes a more perfected and subtle instrument.

This complex nature of capitalist firms also calls for mechanisms of coordination of activity and the use of rules, i.e., '... the fundamental organizing principles underlying decisive breaks in or interventions into control of the [business]' (Clegg, 1981, p. 546). Rules—used here in a broad sense—are historically constituted and embedded in how the organization operates. The conception of business activities is specified within the framework of rules inscribed in policies, procedures, plans, programs and budgets. In this framework, management acts as an agent to control labor and maximize efficiency of the latter (Braverman, 1974, p. 16). The conflict of interest between labor and management that produces the conflicting relationship between the two necessitates the use of appropriate control mechanisms to ensure the execution of work within this framework. The complexity of modern capitalist enterprises also facilitated the development of a new working class with diverse specializations organized into different divisions/departments (Braverman, 1974; Thompson, 1967). The inherently conflictual relations of management and labor in the context of organizational complexity calls for internal auditing services to facilitate monitoring business activities and making necessary interventions to ensure achievement of the required profit goals.

The developments in the accountability landscape of late nineteenth and early twentieth century capitalism strengthened the managerial class that started to emerge earlier the nineteenth century (Johnson & Kaplan, 1987) aiming to promote the maximizing profit for shareholders, for instance, by maximizing efficiency of labor and cutting costs. Contemporary management employs various tools of conceptualization to plan business activities to achieve corporate objectives. The following quote from Taylor (1947, p. 49) shows that this notion has been applied since the scientific management era:

...the essential idea of the ordinary types of management is that each workman has become more skilled in his own trade than it is possible for anyone in the management to be, and that, therefore, the details of how the work shall best be done must be left to him. The idea, then, of taking one man after another and training him under a competent teacher into new working habits until he continually and habitually works in accordance with scientific laws, which have been developed by someone else, is directly antagonistic to the old idea that each workman can best regulate his own way of doing the work. And besides this, the man suited to handling pig iron is too stupid properly to train himself. Thus it will be seen that with the ordinary types of management the development of scientific knowledge to replace rule of thumb, the scientific selection of the men, and inducing the men to work in accordance with these scientific principles are entirely out of the question. And this is because the philosophy of the old management puts the entire responsibility upon the workmen, while the philosophy of the new places a great part of it upon the management.

The value chain (Porter, 1985) is one such tool employed as an illustrative lens for the present

analysis. This tool enables management to understand the discrete ensemble of activities that constitute the organization. The activities in the value chain are classified into primary activities, i.e., inbound logistic, production, outbound logistics, marketing and customer service; and support activities comprising firm infrastructure, human resource management, procurement, and technology development (Porter, 1985, p. 37). As knowledge and control are interrelated (Law, 1986), effective control of the firm presumes management's detailed knowledge of the firm conceptualized in tools such as the value chain. This crucial concept can be applied to capitalist enterprises to understand and analyze relationships among the components of the organization. The concept of totality is contained in the mutually interdependent components that contain the principles of the whole organization (Burawoy, 1979). The value chain is also amenable to deconstruction into discrete elements to make it the object of monitoring, review, audit and intervention. In addition, functional abstraction of such a system can show us how each discrete component maps onto the achievement of the goal of the enterprise. Clear objectives in such a system shape the behaviors of individuals and determine their actions, which are carried out within internal and external constraints (Rasmussen, 1997). Organizational policies and rules as well as external laws and regulations delimit the boundaries of acceptable and desirable activities in the effort to achieve these goals (Thompson, 1967).

In contemporary capitalist enterprises, both conflict and consensus remain key features of the terrain of accountability. This point implies that coercion and direct control are not sufficient strategies to achieve the desired results in the context of social control. The role of labor unions (Friedman, 1977; D. M. Gordon, Edwards, & Riech, 1982) and respect for minimum worker rights stipulated in legislation (Burawoy, 1979) undermined the role of coercion as a management strategy since decisions such as arbitrary firing are likely to prove a problematic option. Instead, Gramsci's (1971) notion of exercising hegemony becomes relevant, in which spontaneous consent and coercion explains the relations between management and employees (Burawoy, 1979). Thus, a key paradoxical is evident in the capitalist accountability framework. As Burawoy (1979) highlights refers to this paradox as

[...] *the assumption of underlying harmony and the necessity of social control*. Taken together, these premises appear contradictory; for if there is underlying harmony and consensus is not problematical, then why is social control important or necessary? And conversely, if social control is so important, then how can we take consensus as given?" [Emphasis in the original]

The prevalence of conflict makes controls a key feature of organizations. Controls aim to ensure circumscription of idiosyncratic behaviors and diverse interests of individuals in ways that are conformant with organizational rationalities (Tannenbaum, 1967). This notion indicates that control and deviant tendencies are inherent in the accountability relations of organizations. Consequently, monitoring and assurance technologies such as internal auditing become necessary to ensure conformity. Conflict could be partly resolved through enhancing the economic logic of management, restructuring jobs and deploying employee-centered management (Burawoy, 1979). Burawoy's (1979, p. 11) focus was to analyze resolution of the paradox when he states:

[...] an underlying, ever-present, and structured conflict is postulated, so that, to the extent that harmony prevails, social control must also be ubiquitous and systematic. Moreover, the outbreak of conflict signifies not some irrationality but rather a lapse of, or inadequate, social control.

The rise of more bureaucratic forms of control, a more human relations oriented management,

and the importance of external forces on labor-management relations all accord to the shift in labor management-relations during the twentieth century (Burawoy, 1979). The transformations of work in the twentieth century resulted in a shift from direct control through foremen to situations where the sharp distinction between managers and workers became blurry while still the relationship is hierarchical. The elimination of personalized nature of the relationship between supervisors and labor under advanced capitalism necessitated bureaucratic forms of control (R. Edwards, 1979). Such changes facilitate the rise of the demand of internal auditing to assist management and the board in managing risk to ensure that organizational rationalities are addressed, bureaucratic controls are complied with and the accountability relations reproduced.

3. Risk management, accountability and internal auditing

The increased size and complexity of capitalist firms makes risk management a crucial activity in governing organizations (Beasley, Cluneb, & Hermanson, 2005). Current thinking that risk management is fundamentally a control problem (Committee of Sponsoring Organisations, 1992; Spira & Page, 2003) illuminates the centrality of the assistance of internal auditing in risk management. Conceptualizing the risk management rationale of internal auditing requires unpacking the concept of risk and its management. Risk refers to “the extent to which there is uncertainty about whether potentially significant and/or disappointing outcomes of decisions will be realized” (Sitkin & Amy, 1992, p. 11). The present analysis adopts Selim and McNamee’s (1999) definition of risk as ‘*uncertainty about events and/or their outcomes that could have a material effect on the goals of the organization*’ (emphasis in the original), which is consistent with the broad definition of risk by Sitkin and Amy (1992). This view is also consistent with the definition of business risk [1] adopted by the International Federation of Accountants (IFAC) (International Federation of Accountants, 2010), which regards failure to achieve organizational goals as the essence of risk.

The efficiency imperative and the need to achieve organizational goals, which serve as the organizing logic for managing complex organizations (Thompson, 1967), are closely intertwined with the notion of risk management. The management of risk involves undertaking three tasks: defining the goals of the organization, identifying the potential drivers of risk and laying out appropriate risk responses (Ritchie & Brindley, 2007; Sitkin & Amy, 1992). The first two components in this process concern themselves with the general principle of risk assessment and the response aspect is another principle, i.e., control action, invoked to ensure that goals are achieved (Boehm, 1991). Despite variations in practice across countries (Demidenko & McNutt, 2010; Sarens & Christopher, 2010), risk management is regarded as a key component of corporate governance that enables organizations to fulfill goals (Subramaniam, McManus, & Zhang, 2009). Considering the definition of internal auditing in view of the definition of enterprise risk management (ERM), which is a central notion in the governance of contemporary organizations (Beasley et al., 2005; Gordon, Loeb, & Tseng, 2009), clarifies the role of internal auditing as a risk management technology. Committee of Sponsoring Organizations (COSO) (Committee of Sponsoring Organisations, 2004) defines ERM as a:

process, effected by an entity’s board of directors, management and other personnel applied in strategy setting, and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

The complexity of business and the external environment within which firms operate make it

evident that goal achievement of enterprises can be beset by eventuation of risk. Contemporary society is considered to have reached a point where risk is too large to manage through insurance and also difficult to make of statistical prognosis (Beck, 1992). Aradau and Munster (2007) concur with the notion of size, complexity and the impracticality of statistical prognosis of risk, but argue that society governs risk through a different approach. They contend that risk is amenable to governing through technologies that (Aradau & Munster, 2007; Diprose, Stephenson, Mills, Race, & Hawkins, 2008). Internal auditing can be interpreted as a technology employed and an assurance and advisory employed to ensure that risk is managed through proper conception and execution of business activities.

Situating the analysis of internal auditing in this arena helps us understand the organizational rationale for internal auditing and conceptualize its mode of operation. The role of internal auditing has been transforming along with changes in its environment. Prior to the 1940s, internal auditing was mainly focused on checking propriety of transactions and records. The development of information economy based on the concept of systems in the 1940s facilitated the emergence of modern internal auditing with a focus on systems evaluation (McNamee & McNamee, 1995). The developments in management of the firm up to the 1940s—explained in the preceding section of this paper—created the conditions for the rise of internal auditing. The formation of the Institute of Internal Auditors (IIA) in 1941 serves as a land mark for this development (Ramamoorti, 2003). As also emphasized in the definition highlighted earlier (The Institute of Internal Auditors, 2010), contemporary internal auditing is concerned with not only providing assurance on compliance with policies and procedures but also offering a value adding service with a broad scope of activities including assisting organizations in risk management (McNamee & McNamee, 1995). The shift in emphasis of internal auditing is a result of internal and external pressures on organizations that caused changes in responsibilities of boards of directors, management and external auditors (Spira & Page, 2003).

Internal audit's concern with economy, efficiency and effectiveness (Al-Twajry, Brierley, & Gwilliam, 2003; San Miguel & Govindarajan, 1984), i.e., 3Es, is closely aligned to the notion of risk management in complex organizations. This focus indicates that internal auditing assists management by making visible potential disturbances that could hinder the ability of organizations to achieve goals. Within the framework of organizational policies and procedures that serve as control parameters, internal auditing assists the board and management in managing risk. The assurance aspect of internal audit helps prevent and detect irregularities that result from mistakes or fraud while the consulting dimension helps enhance economy, efficiency and effectiveness (Al-Twajry et al., 2003; Allegrini & D'Onza, 2003). Internal audit's role in enhancing financial reporting quality and audit committee effectiveness (DeZoort et al., 2003) relates to results controls. Assurance services of internal auditing enhance worker accountability to management (Gramling et al., 2004; Mihret et al., 2010), which mainly serves an action control purpose.

Internal audit's role in the mitigation of wastage of capital through fraud deterrence (Beasley, Carcello, Hermanson, & Lapides, 2000; Raghunandan & Mchugh, 1994) originates from the risk management imperative (Spira & Page, 2003). Likewise, the provision of consulting services on the efficient and effective use of resources (Al-Twajry et al., 2003) helps management address risks *ex ante* by identifying conditions that potentially hinder the enterprise from achieving corporate goals and suggesting solutions to address them. By doing so, internal auditing can help management to meet profit targets and achieve other efficiency goals (Mihret & Woldeyohannis, 2008). From the accountability perspective, therefore,

internal auditing can be considered as serving a useful function by helping maximize wealth as well as reduce wastage and devaluation of capital that could result from fraud and inefficiency. Internal auditing assists enterprises to manage the risk of failing to meet profit targets and remain profitable despite external risks that may be posed by brisk competitive markets.

Historical transformation of internal audit's role has been consistent with the dominant risk factors facing organizations. Internal audit's primary fraud detection focus prior to the 1930s shifted into accounts verification afterwards (Vanasco, 1998). In contemporary organizations, internal auditing plays a crucial role in enhancing quality of corporate governance (Cohen, Krishnamoorthy, & Wright, 2004; Spira & Page, 2003) and providing assurance to boards of directors on managing risk (Sarens et al., 2009) thereby providing them with comfort in this regard (Carrington & Catasús, 2007; Sarens et al., 2009). The empirical literature also provides evidence that companies' internal audit budgets are positively associated with the level of risk (Joseph V Carcello, Dana R Hermanson, & K Raghunandan, 2005b) and the commitment of organizations to manage risk (Goodwin-Stewart & Kent, 2006). It 'serves as a resource to each of the other three cornerstones [i.e., board of directors, management and external auditors] of corporate governance' (Gramling et al., 2004, p. 194). Furthermore, the enactment of the Sarbanes-Oxley Act following the financial reporting scandals of the early 2000s affirmed the importance of internal auditing in corporate governance (e.g. Antoine, 2004; Carey, Subramaniam, & Ching, 2006; J Christopher, Sarens, & Leung, 2009). Under this act, New York Stock Exchange listed companies are required to maintain internal audit departments that provide assistance to the audit committee in risk management and ensuring sound internal controls are in place (Carcello et al., 2005b; Gramling et al., 2004). The extant literature shows that the assurance focus of internal auditing promotes internal audit independence (J Christopher et al., 2009; Jenny Goodwin & Yeob, 2001); whereas, the consulting paradigm advocates the notion that internal audit operates as a partner of management (Bou-Raad, 2000; J Goodwin, 2004; Roth, 2000, 2002). Nevertheless, the literature shows contemporary internal auditing has been embracing the consulting focus in its role (Cooper, Leung, & Wong, 2006) while the traditional compliance focus remains evident as well (Allegrini, Paape, Meville, & Sarens, 2006; Hass, Abdolmohammadi, & Burnaby, 2006; Mihret & Yismaw, 2007).

Business activities of firms assembled around analytical platforms such as the value chain serve as the object of internal auditing. Such tools illustrate how the relationships among various activities in the organization are configured toward the common goal that ties all parts of the organization together. Such platforms help abstract, plan and record the actual operation of the firm on paper. The articulation of business activities in such tools also enables the identification of relevant risks and the steps necessary to address these risks. Internal auditors provide recommendations for improvements in the systems of the value creation activities to the management and operators of the activities through internal audit's focus on 3Es. This role serves both consulting and assurance purposes. Individual components as well as various subsets of the value chain could be an object of internal audit reports to top management and the board. Hence, internal auditing can be considered as a technique that provides selective visibility of areas that need management intervention when risks are identified.

To address the issues arising from divergent interests, scientific management approaches invoked: a) accumulation of knowledge; and b) dissociation of brain work from execution (Taylor, 1947, p. 112-3). This systematization of knowledge helps achieve the goal of the

firm and at the same time gives rise to the need for monitoring and assurance mechanisms. This situation demonstrates that the tension between management and workers is unavoidable given the inherently conflictual nature of the relationship. The fall of pre-calculation of targets and the planning of work in the hands of management shifts power to management. Thus, the power and resources needed to develop knowledge are retained by management; hence, workers lack the motivation to develop knowledge. The shift in control strategies that occurred during the twentieth century matched the changes in the working relations and the conceptions of these relations. The control context characterized by the separation of planning and execution of activities separated in time and space (Thompson, 1967) coupled with the antagonistic nature of social relations of capital and labor necessitate the use of internal auditing as a system of assurance within the organization to reduce risk exposures. Dimensions of performance, risk drivers, exposures and the responses that are applicable in the circumstances (Ritchie & Brindley, 2007) are implied in the planning and execution of internal auditing as suggested by the professional standards for the practice of internal auditing (The Institute of Internal Auditors, 2008).

In an organizational context with institutional control mechanisms, the criteria employed to measure organizational success and failure serve as input for internal audit work. Planning and monitoring of business activities are intertwined in this context since management is interested in ensuring that the organization is functioning as intended. Also, rational knowledge becomes necessary to carry out informed intervention (Miller & Rose, 1990) to ensure achievement of goals in the face of high risk. Employees and the management share common interest in addressing the control problem and ensuring the continuity of the accountability relationships (Bryer, 2006a; Littler & Salaman, 1982). Nevertheless, as such common interest does not signify the absence of tension and contradiction, a complete unity of interests cannot be achieved. This makes organizational life beset by tensions and contradictions, which in turn call for risk management technologies. Hence, risk management can be regarded as a control problem in a general sense (Rasmussen, 1997).

The Committee of Sponsoring Organizations (COSO) framework's definition of internal control [2] affirms the risk management conceptualization of internal controls (Committee of Sponsoring Organisations, 1992). Such a broad scope of internal controls created opportunities for internal auditing to provide consulting and assurance services that inform management and the board in the management of risk. Management took responsibility for internal control systems and board of directors' responsibility expanded to incorporate organizational prosperity as well as accountability to shareholders. The shift in top management responsibility about internal control from compliance with policies to a focus on significant risks fostered the role of internal auditing (Spira & Page, 2003). Consistent with this point, internal auditors' intimate knowledge of organizational idiosyncrasies and their central role in risk management was one of the major premises of the IIA's stand against outsourcing of internal audit to external auditors (Covaleski, Dirsmith, & Rittenberg, 2003; Rittenberg & Covaleski, 2001).

4. Conclusion

By drawing on the concept of accountability, this paper has shown how capitalism created the conditions that produced the demand for internal auditing as a risk management technology providing: (a) *ex post* assurance services on the execution of the 'distant' business activities according to management's conceptions, and (b) *ex ante* advisory services on enhancing efficiency and effectiveness of the firm. The paper has articulated the risk management rationale of internal auditing by tracing the historical development of the function within the

transformation of the accountability relationships in capitalist firms. This relationship comprises multiple levels of control in which internal auditing is conceptualized as a historically constituted technology that has developed along with the institutionalization of structural control mechanisms in the twentieth century capitalist enterprises. These enterprises involve inherently conflictual relations that characterize the accountability relationships of shareholders, board of directors, management and employees.

It can be seen from the analysis in this paper that the conceptualization of the role of internal auditing as historically constituted along with the development of late nineteenth and early twentieth century capitalism in the USA and the accompanying rise of management approaches requires a qualification. That is, the separation of ownership and control of organizations occurred in Western Europe, especially in Britain and France, earlier than it happened in the USA (Hannah, 2007). Furthermore, internal audit type activity referred to as “continuous audit” was conducted in Britain in the nineteenth century (J. R. Edwards, 2012) earlier than the period covered in the present paper. These points show that the conceptual formulation developed in this paper can be considered as generic despite being empirically grounded in the context of the USA where internal auditing as practiced today became formalized. Thus, it can be concluded that accountability perspective explains the role of internal auditing in any capitalist social formation beyond the temporal and spatial focus of the present paper.

With the understanding that the mainstream accounting literature has not fully explained contemporary issues of accountability (Neimark, 1994), the critical literature argues that accounting control systems serve to ensure accountability in the value creation process (Rob A Bryer, 1999; Bryer, 2006a). The present paper contributes to this literature in general. Nevertheless, being the first major attempt to conceptualize internal auditing from an accountability perspective, it needs to be acknowledged that the paper raises more issues than it resolves. The arguments developed in the present paper calls for empirical studies to refine the conceptualization advanced here. Overall, the paper has shown that the accountability perspective provides a useful conceptual framework and analytical insights for the thinking and empirical investigation of the role of internal auditing in assisting management and the board of directors in managing risk within an integrated framework of accountability.

Notes

1. IFAC defined business risk as “[a] risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.”
2. COSO defines internal controls 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 in the following categories:
 - . Effectiveness and efficiency of operations
 - . Reliability of financial reporting
 - . Compliance with applicable laws and regulations.’ (Committee of Sponsoring Organizations 1992, p. 9)

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