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Internal auditors' use of interpersonal likability, arguments, and accounting information in a corporate governance setting ☆

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ABSTRACT

Internal auditors play an important role in influencing managers' judgments. Yet, the practitioner literature indicates that, because internal audit lacks the client services incentives of external audit, internal auditors often adopt a "policeman approach" that can lead to negative interpersonal relationships with managers. We investigate three variables fundamental to internal auditors' ability to influence managers: (1) internal auditors' interpersonal likability, (2) the information used to support their positions, and (3) whether they present that information in a thematically organized argument. We find that managers agree more with an internal auditor who is *both* likable *and* uses a thematically organized argument. We find further that this joint effect occurs regardless of whether the internal auditor's information is relatively supportive or unsupportive of his position. Overall, our theory and findings suggest that an internal auditor can achieve agreement from managers on important corporate governance issues with this fairly straightforward presentation tactic, even when the underlying information is relatively unsupportive and managers otherwise tend not to agree with the internal auditor's position. Our study contributes to accounting, psychology, and writing and discourse theories with new evidence of the effects of an argument structure (holding the underlying information constant) on users' judgments, and how those effects depend on the likability of the source of information. Our findings have important implications for internal auditors, managers, external auditors, and others interested in corporate governance.

Introduction

In this study, we examine how three variables, each fundamental to internal auditors' interactions with managers, explain internal auditors' influence on managers' judgments: (1) internal auditors' interpersonal likability, (2) the underlying information supporting their positions, and (3) their use of thematically organized arguments to present that information to managers. As Prawitt, Smith, and Wood (2009, p. 1258) point out, internal auditors tend to interact with managers frequently, and are "often the party primarily responsible for the day-to-day monitoring of management's actions, including those related to external financial reporting" (see also Bariff, 2003; Cohen,

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Hayes, Krishnamoorthy, Monroe, & Wright, 2013; Mercer, 2004).

The practitioner literature indicates that the tone of the interactions between internal auditors and managers varies widely in practice (Deloitte, 2010; Dittenhofer, Ramamoorti, Ziegenfuss, & Evans, 2010; Pickett, 2010; Ratliff & Brackner, 1998). Clearly, many internal auditors have exceptional interpersonal interactions with managers. However, Pickett (2007, 2010) notes that internal audit lacks the client services incentives of external audit, allowing internal auditors to adopt a "policeman approach," which places little emphasis on positive interpersonal interactions with managers as clients, compared to external audit. Deloitte (2010) similarly notes that the "police" approach to internal audit can harm the manager–internal auditor relationship, and contend that "a dysfunctional relationship [between managers and internal auditors] is a contributing cause, and in some cases, a primary cause" of a variety of accounting problems, including "material weaknesses, financial restatement, regulatory compliance, and the like" (p. 3). Despite the importance of the interpersonal relationship between internal auditors and managers, Archambeault, DeZoort, and Holt (2008), and Prawitt et al. (2009) point out that it has received relatively little research.

We develop theory and experimentally test how internal auditors can use arguments, personal likability, and information to influence managers' judgments. According to theories of writing and discourse, an *argument* is a flowing arrangement of information into thematically connected groups in support of a particular conclusion (e.g., Conners, 1981; Smith, 2003). However, individuals often simply provide information in support of a position as it comes to mind, without organizing it into a structured argument, leaving it to the user to decide how the pieces fit together (Booher, 2001; Guffey, 2010; May & May, 2012). The internal audit practitioner literature indicates a wide variance in the effectiveness of internal auditors' use of arguments in practice (Chambers, 2009; Dittenhofer et al., 2010). For example, Chambers (2009) interviewed managers and executives who indicate that internal auditors often do not provide information in a manner that allows users to easily see how related pieces of information connect together. In other words, internal auditors provide information, but without always structuring it into a coherent, thematically organized, flowing argument (cf. May & May, 2012).

Writing and discourse scholars distinguish arguments (which organize information supporting a position into thematically connected groups) from at least three other forms of rhetoric: narration (connecting information into temporal order), description, and exposition (e.g., Conners, 1981; Smith, 2003). As an example, an internal auditor using an *argument* to recommend a write-down of obsolete inventory (cf. KPMG, 2003) could structure information into thematically connected groups by, for example, first introducing the state of the inventory and its competition, then discussing information about how slowly the inventory is selling, followed by details about the technologically superior products, then discussing the viability of any other sales prospects for the older inventory, etc. Prior research has shown how other ways of structuring information (holding the underlying information constant) influences how users react to that information (e.g., Lipe & Salterio, 2002; Ricchiute, 1992; Sedor, 2002). For example, Sedor (2002) manipulated whether analysts received optimistic earnings guidance in temporal, causal narratives that linked past states of the firm to current states to plans for the future, or the same information in randomized order. Earnings forecasts were more optimistic when a temporally causal narrative format was used.

In our experiment, managers provide a controller with their input into an inventory write-down judgment for their divisions (e.g., Duncan, 2002), while interacting with an internal auditor who prefers conservatively writing-down the value of the inventory in the financial statements (e.g., KPMG, 2003; Mercer, 2004; Moeller, 2009; Prawitt et al., 2009). We examine this setting within a $2 \times 2 \times 2$ experimental framework, in which the internal auditor is either interpersonally likable or dislikable, and presents information that is either more supportive or less supportive of write-down, in either a coherent, thematically flowing argument structure or not. Similar to Sedor's (2002) manipulation of temporal narratives, our manipulation of arguments holds the underlying information about inventory constant by comparing the argument condition to a condition in which the internal auditor presents the same statements about inventory in an unorganized order.

We combine theories from writing and discourse, psychology, and accounting to build our predictions. Because people find the thematically structured flow of an argument appealing, and because positive affective states lead to heuristic processing, we predict that managers will heuristically agree more with an internal auditor who is both likable and uses an argument structure, beyond the effects of how supportive or unsupportive the internal auditor's information is of his position. Our findings are consistent with this hypothesis. First, our most basic finding is that managers (unsurprisingly) agree more with an auditor who uses more supportive information than one who uses less supportive information. However, beyond that, they *also* agree more with an internal auditor who is *both* likable *and* uses a thematically organized argument structure, *regardless* of whether the information presented is relatively supportive or unsupportive of the internal auditor's position. In fact, our results demonstrate that an internal auditor can achieve (on average) agreement from managers simply because he is likable and uses a flowing argument structure, even when the underlying information is relatively unsupportive and managers otherwise (on average) do not to agree with the internal auditor. Overall, our theory and findings suggest that internal auditors can achieve additional agreement from managers on important corporate governance issues, above and beyond how supportive or unsupportive their information is, by using an argument structure and likability jointly, as a fairly straightforward presentation tactic.

This is the first study of which we are aware to demonstrate how structuring information into thematically organized arguments (holding constant the underlying information presented) interacts with an information