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EXAMINING THE INFLUENCE OF CONFLICT MANAGEMENT STYLES ON EXTERNAL AUDITORS' RELIANCE DECISIONS REGARDING INTERNAL AUDIT WORK

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Abstract:

This study examines whether external auditors' conflict management styles influence their reliance on internal audit work, and whether reliance decisions differ by auditor rank. Drawing on prior work on auditor judgment and professional scepticism, the study extends existing research by focusing on behavioural differences among external auditors rather than only on internal audit attributes such as competence, objectivity, and work performance. Data were collected through a questionnaire survey distributed to 250 audit firms in Wilayah Persekutuan, Malaysia, of which 109 usable responses were received. The instrument included a case-based analytical procedures task and items measuring conflict management styles using the Organizational Communication Conflict Instrument. The findings indicate that external auditors' conflict management styles are associated with their reliance decisions regarding internal audit work. In particular, a flexible working style, interpreted as a more active engagement style, is significantly and negatively related to reliance on internal audit work, suggesting that auditors who are more active in managing disagreement tend to rely less on internal auditors and exercise greater professional scepticism. The results also show differences in reliance judgments by

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rank: audit managers demonstrated higher reliance on internal audit work than senior executives. This may reflect differences in experience, judgment, and resource considerations across audit positions. The study contributes to the literature by highlighting the role of individual behavioural style in external auditors' reliance decisions, an area that has received limited attention in prior research. The findings have practical implications for audit firms, particularly in auditor training and the development of professional scepticism and effective conflict-handling skills. Future research may adopt experimental methods, include broader organizational variables, and use more representative samples across firms and industries to strengthen understanding of reliance judgments in the Malaysian audit environment.

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Keyword:

Conflict, External Auditor, Internal Auditor, Reliance

Introduction

Historically, several high-profile auditing scandals in Malaysia, including Transmile Group (2005 audited financial statement subject to reissue); NasionCom Holdings (missed the dateline for the submission of 2005 and 2006 audited financial statement); Megan Media Holdings and Ho Hup Construction (special audit due to auditors' failure to determine "true and fair view") (Paino 2010) has tarnish the auditors reputation badly. External auditor's failure to give appropriate opinion on the fairness of the financial statements not only tarnish the image of the audit firm but the image of the country at large. Amongst root cause that has been identified to contribute for such scandals is auditor failure to consistently apply judgment on appropriate nature, timing and the extent of audit scope that is responsive to the risk of material misstatement. This problem was highlighted as major deficiency in Audit Oversight Board (AOB) Annual Report 2014. The exercise of professional judgment becomes complex as auditing process is described as a sequences of processes, starting with environmental analysis to formation of auditor's opinion on the client's financial statements (Bamber, 1980); each stages of the audit process requires an external auditor to exercise their professional judgment to enable them to proceed to the next stages (ISA 200: A27).

Recent guidance from the ISA 315 (IFAC 2012) addressed how the knowledge and experience of the internal audit function can inform the external auditors' understanding of the entity and its environment and identification and assessment of risks of material misstatement. The Public Companies Accounting Oversight Board (PCAOB) has recommended that external auditors "rely (more) on the work of others" to reduce the greater-than- expected corporate (audit client)

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costs associated with complying with Section 404 of the SOX (PCAOB, 2007a). From the perspective of the PCAOB, an external auditor that appropriately relies on the work of others such as internal auditors can achieve enhanced audit efficiency without a loss of effectiveness (Brody 2012). An important judgment for external auditors is whether to rely on internal auditors' work. This judgment has been one of great contention for years with external auditors tending to rely less on than what the audit clients prefer. A reliance decision is critical decisions that require professional judgment and may be influenced by a number of factors. Munro and Stewart (2011) highlighted that external auditors' reliance on internal auditor had been researched for almost three decades (Clark, Gibbs & Schroeder, 1980) ; Margheim, 1986 ; Schneider, 1985), the focus of many studies had been on objectivity, work performance and competence of the internal audit function (Brown, 1983: Krishnamoorthy, 2002; Messier & Schneider, 1988; Schneider, 1984). Limited research, however, has been conducted to investigate differences in individual external auditor's reliance judgments, especially since the passage of SOX. Current study intends to replicate the research by Brody (2012) in determining the influence of the auditors' conflicts management styles towards external auditors' reliance decisions on internal auditors' work in Wilayah Persekutuan Malaysia. Furthermore, current study intent to examine the effect of working experience (Manager versus Senior Executives) on external audit reliance decision.

Literature Review

Reliance on Internal Auditor Work

External audit reliance on internal auditor's work has been researched for almost three decades. Bame-Aldred et al., (2013) summarised that, study on determinant of external auditor reliance on internal audit work centred on internal audit quality attributes namely competence, objectivity, and work performance. This is consistent with the requirement under ISA 610 (which require external auditor to assess internal audit quality beforehand. Previous research on each of the determinant of external auditor reliance on internal audit work is discuss in the following section.

Competence

Internal auditors' competency has been identified by many researchers as the factor affecting external auditors' reliance decision. Arens and Loebbecke, (1991) defined competence as a "*member who accepts a professional engagement and implies that he has the necessary technical knowledge to complete the engagement*". Amongst internal audit attributes associated with competency that proven to increase external auditor's reliance includes Certified Internal Auditor (CIA) certification (Messier & Schneider, 1988: Myers & Gramling, 1997); internal audit training programme, with an emphasis on professional certifications (Brown 1983); internal audit experience (Messier & Schneider, 1988); and educational background (Alan Reinstein et al. 1994). Specifically, Beasley, Carcello, Hermanson & Lapides (2000) found that external auditors preferred internal auditors with accounting/ auditing qualifications due to the facts that its increase internal auditor ability to spot and prevent financial statement frauds.

In addition to the earlier evidence, a number of studies found internal audit department's age (number of year establishment) as a function of competency (Petty, 1996; Bell, Marrs, Solomon & Thomas, 1997: Mohamed, 2013)) . The longer the age of the internal audit department, the higher the level of competencies in terms of familiarities and in-depth knowledge of a company's operations, processes and system (Petty, 1996; Bell, Marrs, Solomon & Thomas, 1997). Mohamed (2013) highlighted that in depth knowledge of auditable areas is crucial in performing effective audits. Moreover, the authors found that external auditor reduce external audit fees as a result of high internal audit quality (competency and contribution towards financial statement audit). The substitution of external audit function by internal audit (reliance on internal audit work) should result in reduction of external audit work and subsequently contributes to low monitoring cost and reduction in audit fees (Ho & Hutchinson 2010).

Besides age, the size of the audit department also found to be the indication of internal audit competency (Al-Twaijry, Brierley, & Gwilliam, 2004: Carcello et. al., 2005: Goodwin-Stewart & Kent, 2006: Ho & Hutchinson's, 2010). Evidence from the Saudi Arabian (Al-Twaijry et al. 2004) revealed that the root cause for low reliance by external auditor is due to the size of the internal audit department in that region. Most respondent believe that small internal audit department represent low number of certified internal auditor and limited scope and resources for internal audit development (i.e. in term of training and scope of work). In contrast, study done in Hong Kong showed that the external auditors are willing to rely on internal audit work and this has been translated into lower external audit fees charges (Ho & Hutchinson 2010). The study proven that large size of internal audit department influences such reliance based on the facts that large internal audit firm focus on activities related to financial statements, system development and maintenance, operations efficiency and effectiveness, fraud investigations and unlimited access to internal auditors' working paper (broader scope).

Prior research found that risk management, internal control and corporate governance were related to the size of internal audit functions (Goodwin-Stewart & Kent, 2006). The authors found that the large firms would be associated with large internal audit department which focused on minimum reliance of Big 4 auditors and instead had more frequent audit committee meetings (a more diligent audit function). Accordingly, Carcello et. al., (2005) found that internal audit resources were positively related to company size, leverage, industry, relative amount of inventory, operating cash flows, and audit committee review of the internal audit budget. This as an indication that large firm usually aware of the important of having high-quality audit department which is translated via the huge resources allocated to the internal audit department.

Objectivity

The term objectivity has been defined as a state of mind, a quality that lends value to a member's service. It is a distinguishing feature of the profession. The principle of objectivity imposes an obligation to be impartial, intellectually honest and free of conflicts of interest (Carmichael et al. 1996). A considerable amount of literature has been published on external auditor's examination of internal audit objectivity. Among them focuses on internal audit reporting line (i.e. Al-Twaijry, Brierley, & Gwilliam (2004): Munro and Stewart's, 2011) and external auditor client's identification (i.e. Bamber & Iyer, 2007: Balkaran, 2008: Stefaniak, Houston, & Cornell, 2012).

Admittedly, internal auditor independence from management adversely affected the external auditors' willingness to rely on internal audit work. Earlier, Al-Twaijry et al., (2004) found external auditor reluctant to rely on the work of Saudi Companies internal auditor. This is based on their perception that Saudi companies are lacking in professionalism and independence from

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management. Consequently, Munro and Stewart's (2011) examination of the internal audit reporting relationship to Audit Committee in government sector provided evidence that the said relationship did have impact on external audit reliance decision. The objectivity of the IAD can also be assessed through the openness and the readiness of internal auditors in term of access to their working paper. Reinstein, Lander and Gavin (1994) found that external auditors review working papers to evaluate internal audit opinion.

Despite the negative impact of internal audit reporting to management, few study found positive side of it. For instant, Stefaniak et al., (2012) used experimental data to compare the levels and effects of employer (client) identification on the control evaluations of internal (external) auditors. This is the first research that provides evidence that internal (external) auditor perceived a greater (lower) level of internal control deficiencies identification from employer (audit client). Furthermore, the findings of this study supports Bamber & Iyer (2007) results by discovering that higher levels of external auditors' client identification were associated with more lenient control evaluations. An opposite effect is found, for internal auditors' higher levels of internal auditors' employer identification are associated with less lenient control evaluations, which mean they tend to support management's preferred position to a lesser extent. The study not only provides initial evidence of external auditors' increased reliance on internal auditors' work; but also showed an improvement in audit efficiency and audit quality through less lenient internal control evaluations. Balkaran, (2008) stressed out that internal auditors could provide objective and value- added feedback to shareholders because the internal auditors do not require annual renegotiation of employment contracts and could demand long-term or even tenured employment. Brandon (2010) interviewed 89 experienced external auditors to investigate whether external auditors would evaluate and rely on outsourced internal auditors' work differently when the internal auditors simultaneously provided non-audit services. The results showed that outsourced internal auditors' objectivity was negatively affected by provision of non-audit services. However, it could be neutralized by assigning different staff to perform non-audit services.

Work Performance

Work performance or scope of function refers to the nature and extent of internal auditing assignments performed (IAASB 2013). Besides professional competence, work performance or scope of function is the most influence factors impacted external auditor in making reliance judgment (Tiessen and Colson, 1990): Haron, Chambers, Ramsi, & Ismail, 2004). Several studies found external auditors expected less audit effort (Marwick, 1999; Clark, Gibbs & Schroeder, 1980) and lower budgeted external audit hours (Maletta & Kida, 1993: Felix, Gramling & Maletta, 2001) as a result of reliance on the internal auditors' work based on their knowledge of company operations, processes, and procedures. Specifically, strengthening internal audit function in the area of financial statement audit, could foster internal-external audit coordination (Felix et al. 2001) and would enhance corporate governance effectiveness (Mihret & Admassu 2011).

The reliance on internal auditors will be higher if their functions also consist of examining financial statements and external audit related matters. Early evidence to support this notion is study done by Cooper, Leung & Chau (1989) of CEOs in Hong Kong, where the respondents identified the main functions of the internal audits which included independent appraisals of the internal control system, independent review of the efficiency of operations in the organization, and proper safeguarding of assets as well as preventing and detecting fraud and error; all which fall under the areas of interest of external auditors. In addition, the scope of function that found to increase external auditor reliance on internal audit work includes; systems development and maintenance (Walker (1996): Ho & Hutchinson, 2010); value creation activities through assessment and improvement of the effectiveness of risk management, control and governance process (Carcello, Hermanson & Raghunandan, 2005) and special project and fraud investigations (Beasley, Carcello, Hermanson, & Lapides, 2000; Gramling & Myers, 2003). Beasley et al., (2000) found that firms with (without) internal audit support reported less (more) fraud where fraud were mostly detected by internal auditor instead of external auditor. In Malaysia, Fadzil, Haron & Jantan (2005) found that internal auditors' functions included reviewing the operating efficiency and effectiveness of the operations as well as internal control systems and responsible for assessing compliance with company policies, procedures, and statutory requirement.

Financial Statement Quality

The evolution of internal auditor in term of capability and work performance has increase the external auditor's confident to rely on the on internal audit work (Gupta & Ray, 1992:Humphreys, 2008: Schneider, Gramling, & Hermanson, 2009: Mohamed, 2013). In a survey of Chief Audit Executive, Kaplan & Schultz (2006) found that 88% of the respondent stated that external auditor rely on their internal audit work to some extent. Accordingly, PCAOB as the body that responsible for the quality of external auditor is interested to determine the extent to which external audit reliance can either enhance or diminish audit quality (Bame-Aldred et al. 2013). However, there is paucity of research that directly measure internal audit contribution towards external audit quality.

Previous research that examine internal audit contribution to the external audit quality centred towards its indirect contribution towards external auditor's identification and reporting of material weaknesses in internal control (Rae & Subramaniam, 2008: Prawitt, Sharp & Wood, 2011: Lin et al., 2011: Bedard & Graham., 2011):Stefaniak et al., 2012). Rae & Subramaniam (2008) found that internal control procedures quality in fraud detection is significantly and positively related to three key organizational factors namely corporate ethical environment, the extent of risk management training of staff, and the internal audit department activity level. This finding although not directly investigate reliance decisions, indicate that strong internal audit can decrease the risk of material misstatement, thereby indirectly increasing audit quality. In addition, Prawitt et al., (2011) suggest that financial statement quality is improve via internal audit assurance of material weaknesses in incentive system design. Keane (2012) investigated on the impact of internal control weaknesses disclosure to audit fees. The result showed that higher audit fees were charged for companies that disclosed additional internal control weakness and repetitions of internal control weakness in the next audit. Higher audit charges were also being imposed for the first three years after rectification of the internal control weaknesses. This indicates that external audits do rely on the information highlighted by internal auditors such as internal control weakness as a benchmark to decide on the nature and extent of audit testing. Internal control weaknesses areas are considered a high-risk area which warrants a detailed audit procedure.

Internal auditor quality characteristic proven to have inverse relationship with external auditor material weaknesses disclosure. Specifically, such quality include (a) incorporates quality assurance techniques into fieldwork, b) audit activities related to financial statement and c) closely monitors the rectification of internal audit findings (Lin et al., 2011). The quality exhibit

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by internal auditor may leads to better internal control weaknesses discovery and rating. The findings on this issue is inconclusive. Stefaniak et al., (2012) provides evidence that internal (external) auditor perceived a greater (lower) level of internal control deficiencies identification from employer (audit client). Furthermore, the findings of this study supports Bamber & Iyer (2007) results by discovering that higher levels of external (internal) auditors' client (employer) identification were associated with more lenient (less lenient) control evaluations.

The study not only provides initial evidence of external auditors' increased reliance on internal auditors' work; but also showed an improvement in audit efficiency and audit quality through less lenient internal control evaluations. Balkaran, (2008) stressed out that internal auditors could provide objective and value- added feedback to shareholders because the internal auditors do not require annual renegotiation of employment contracts and could demand long-term or even tenured employment. However, Bedard and Graham (2011) findings contradict Stefaniak et al., (2012). They found that internal auditor detects few and less severe control weaknesses as compared to external auditor.

Management Assertion and Conflict between Management and External Auditor

Pre-planning audit stage requires an auditor to assess the risk of material misstatement at assertion level; in which enable them to set the nature, timing and extent of further audit procedure necessary to obtain sufficient and appropriate audit evidence to support their opinion (ISA 315: Para 26). ISA 315 defines assertions as "r*epresentations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur"* (ISA 315 Para 4; page 29). In order to detect material misstatement at assertion level, one of the normal approaches undertake by external auditor is analytical procedures. If the risk is assessed to be higher, the standard audit procedures need to be extended.

Analytical procedures help to highlight high risk areas (Brody 2012). However, interviews are the most pervasive types of audit approach to gather information Koonce, (1992). Hylas & Ashton, (1982) suggested that financial statement errors or fraud would initially be signalled by analytical procedures, and subsequently resolved through interview sessions with management who would be the only reasonable source to answer abnormal trends in analytical procedures (Anderson, Koonce & Marchant, 1994). Instance of abnormal trends that should be investigate further by external auditor is significant unexplained items on reconciliations and unusual changes in trends of financial statement ratios (i.e. account receivables increase more rapidly compared to respective revenues) (ISA 240). Conflicts or disagreement between management and external auditor possibly occur when the justification for abnormal trends in management assertions could not satisfied external auditor or management attempt to conceal material misstatement. **Appendix 1** provides instances of conflicts or problematics relationship between management and external auditor as per of ISA 240 Para 49. The way external auditor deal with these conflicts may affects their judgment on nature, timing and extent of further audit procedure necessary to obtain sufficient and appropriate audit evidence to support their opinion.

External Auditor Conflicts Management Styles

Individual differences between professionals will reflect the way of handling conflict when management assertion does not justify the abnormal analytical procedures results. According to Brody (2012) there are two types of audit engagement work style namely, passive or low active engagement work style and is an active engagement work style. External auditors exercising passive engagement work style tend to more readily defer to management's explanation simply to avoid conflict. Whereas external auditors exhibiting active engagement work style may routinely exhibit greater scepticism and willingness to engage the internal auditors and expand inquiries. Various studies such as (Ting-Toomey, 1986; Wilson & Waltman, 1988) highlighted that conflict is a common phenomenon and exists in various areas of human interactions and organizational life, however its significant consequences to organizations and their members, especially in the audit line is not clear due to limited research being conducted in this area.

Putnam & Wilson (1982) argue that conflict could either result in useful outcomes such as increasing the number of alternatives to be considered or harmful outcomes. The result of the conflict would depend solely on the conflict management style of individuals (Schwenk, 1990; Ting-Toomey, 1986). Schweiger, Sandberg & Ragan, (1986) stated that conflicts perceived as harmful could be avoided by favouring agreement and keeping the disagreement silent (Janis & Mann, 977). Others may view conflict as hostile but productive and constructive (an active engagement work style) (Nemeth, 1986; Tjosvold, 1985).

Studies that examines the effects of conflicts of management style on external auditor reliance on internal audit work (Brody, 2012: Paino et al., 2015) categorised conflicts management styles based on Organizational Communication Conflict Instrument (OCCI) which had been introduced by Putnam and Wilson (1982). The researchers developed OCCI to assess the strategies or working styles used by individuals in managing conflicts in organizational situations (Wilson & Waltman, 1988); which of the working styles chosen when conflicts arose would then, result in either efficient or inefficient results (Deutsch 1969). The conflicts management style were categorised into 5 main operating styles as per Table 1.

Table 1: Types of Conflict Management Styles

Type of Conflict Management Style	Operating Styles
Inaction working style (IWS)	Avoid conflict by denial of any problems
Flexible working style (FWS)	Avoid conflict through compromise
	Avoid conflict through creative resolutions
Inflexible working style (IFWS)	Dominate
Cooperation working style (CWS)	Work around internal auditors

Professional Scepticism

The categorisation of the conflicts management styles is consistent to the concept of professional scepticism under ISA 200. The Standard defines professional scepticism as "an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence (ISA 200: Para 13(l) : page 79). The need to for high professional scepticism is important especially in the event of a) inconsistency in the audit evidence obtained b) information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence c) conditions

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that may indicate possible fraud and d) circumstances that suggest the need for audit procedures in addition to those required by the ISAs (ISA 200: A18)

The external auditor that possesses high professional scepticism will not choose to operate under inaction working style or avoid conflict by denial of any problems. ISA 200 emphasizes that maintaining professional scepticism throughout the audit is necessary to reduce the risk of overlooking unusual circumstances and over generalizing when drawing conclusions from audit observations. The most crucial part of maintaining professional scepticism is to reduce the risks of using inappropriate assumptions in determining the nature, timing and extent of audit procedures and evaluating the results (ISA 200: A19).

Hypotheses Development

Individual differences between professionals will reflect the way of handling conflict, in which conflicts management styles chosen when conflicts arose would then, result in either efficient or inefficient results (Deutsch 1969). Bandura (2001) stated that in many conditions, people do not have direct control over the social conditions and institutional practices that affects their day-today lives. Thus, limit the chances to secure the outcomes they desire, given the scarce of time, energy and resources. In the auditing context, conflicts between the management and external auditor (see Appendix 1) will have an influence towards the efficiency and the effectiveness of the judgement made by the external auditor. For instant, management denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought will result in audit delay (efficiency measure of judgment performance). Furthermore, such denial of access will result in inappropriate judgment made by an individual external auditor (effectiveness measure of judgment performance). The ways external auditor deals with these conflicts might explain the variance in the judgment performance. Auditor exhibit active (passive) conflicts management styles will show high (low) level of professional scepticism (Brody, 2012: Paino et al., 2015). Thus, the former will rely on the management assertion at book value. On contrary, the latter will find alternatives i.e. use of internal audit work to get an appropriate and sufficient audit evidence to decide the nature, timing and extent of their further audit procedure. This led to the following hypotheses:

H1a: External Auditors exhibiting a less “active engagement” working style will assess internal auditors’ work as more useful than auditor with a more “active engagement” work style.

H1b: There is a difference in the reliance decisions made by two different external auditors of different ranks (Manager versus Senior Executive).

Research Design

The detailed survey instrument was adopted from Brody's (2012) study and used to collect data. Sample of 250 external auditors working in various audit firms in Wilayah Persekutuan Malaysia was randomly selected from the Malaysia Institute of Accountant (MIA) website. Only 109 (44%) responses were received (refer Table 2.0 for details). The responses were then analyzed using the Statistical Package for Social Science (SPSS) software version 20 statistical package.

Table 2.0: Participants' Profile

Detail	Particular	Total
Rank	Audit Managers	38
	Audit Senior Executives	34
	Audit Executives	37
Gender	Male	50
	Female	59
Professional Qualification	Member of MIA	37
	Non- MIA Member	72
Average years of experience	6 years	

The twenty-five-page questionnaire instrument was designed with four sections. The first section (Section A) contained a case study which required the respondents to assess the risk and rate the usefulness and reliability of internal audit assertion. The second section (Section B) covered 18 questions on conflicts management styles. Lastly, the last section gathered information about the respondents' profile. In Section A, participants were asked to perform an analytical procedures task during audit planning. They were provided with inventory turnover ratios for the current and prior year and the percentage change. They were then asked to estimate the probability that the 10% decrease in the turnover ratio was caused by 1) an error or irregularity and 2) an environmental change.

Next, the auditors were requested to rate from 0 to 10: (A) the extent they believe the information provided by the IAD was useful (0=not useful at all, 10=very useful) in resolving concerns; (B) the extent they believe the information provided by the IAD to be reliable (0=not reliable, 10=very reliable); and (C) the extent they believe it was necessary to further explore and verify the reasons for the inventory turnover change (0=not necessary at all, 10=very necessary). Respondents were also asked to indicate the probability (allocated 100 points) that the decrease in a company's turnover ratios was caused primarily by accounting errors/ irregularities (RA_F) or environmental changes (RA_NF) before completing the task in the case study. This is a critically important question to be addressed by external auditors in the planning stage that is for risk assessment (Brody, 2012). In Section B participants were asked to filled out survey instruments designed to assess: participants' conflicts management style based on the Organizational Communication Conflict Instrument (Putnam & Wilson 1982).

Result

Correlation and Regression Analysis on Conflict Management Style

As in Table 3.0, the statistical results show that the correlation values among the variables range between -0.304 and 0.364. This indicates that there are no multicollinearity problems among the variables since none of the correlation is more than 0.7. As tabulated in Table 4.6, statistically external audit reliance on internal audit work (RIA) is negatively correlated with all the external audit working styles which are Inaction working style (IWS), Flexible working

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style (FWS), Inflexible working style (IFWS) and Cooperation working style (CWS). However, it is significant and negatively correlated to only IWS and FWS.

Amongst the independence variables, Cooperation working style is significant and positively correlated with IWS and IFWS. Moreover, it is also significant but negatively correlated with flexible working style. Whereas Flexible working style (FWS) is significant and positively correlated with Inflexible working style (IFWS).

Table 3.0: Correlation Coefficient on Conflict Management Style

	RIA	IWS	FWS	IFWS	CWS
External audit reliance on internal auditor work (RIA)	1	-0.129**	-0.208*	-0.089	-0.009
Inaction working style (IWS)		1	0.100	-0.014	0.260*
Flexible working style (FWS)			1	0.364*	-0.304*
Inflexible working style (IFWS)				1	0.128**
Cooperation working style (CWS)					1

*Correlation is significant at 0.05 level (1-tailed)

** Correlation is significant at 0.1 level (1-tailed)

Table 4.0 tabulates multiple regressions to inquire if the external auditors' working styles specifically, Inaction working style (IWS), Flexible working style (FWS), Inflexible working style (IFWS) and Cooperation working style (CWS) are significantly associated with the external audit reliance on internal audit work. Based on the results, the regression is not significant where the F=4.508 and p = 0.013. The multiple R (R = 0.247) shows a low substantial correlation between predictor variables and the dependent variables, thus indicating that the linear regression has predicted low respectable results.

The R^2 value indicates that about 6.1 percent of the variance in the level of external audit reliance on internal audit work is explained by the all the predictors. The adjusted R^2 is 0.025 which means that the regression model has explained 2.5 percent of the four variables in the level of external audit reliance on internal audit work. As tabulated in Table 4.0 the Durbin Watson Statistic is 1.420 and VIF range from 1.420 to 1.088, which indicates multicollinearity assumption is not violated.

Individual differences between professionals will reflect the way of handling conflicts when management assertion does not justify the abnormal analytical procedure result. As expected, the result shows a significant negative relationship between "Flexible working style (active engagement)" and reliance on internal audit work. Among the attributes that portrays active and flexible working style include 1) external auditors try to use the internal auditors' ideas to generate solutions to disagreements 2) external auditors blend their ideas with internal auditors to create new alternatives for resolving a disagreement and 3) external auditors suggest working together with internal auditors to create solutions to disagreements. This indicate that most of the respondent adhered to the ethical requirement under ISA 200 which requires external auditors to plan and perform an audit with skepticism recognizing that circumstances may exist that may cause the financial statements to be materially misstated.

Table 4.0: Regression Result on Working Style

	Coefficients	Std Error	t-stat	p-value	VIF
EA reliance on internal audit work		0.803	10.853		
Inaction working style (IWS)	-0.102	0.080	-1.274	0.206	1.088
Flexible working style (FWS)	-0.175	0.092	-1.911	0.059*	1.361
Inflexible working style (IFWS)	-0.009	0.087	-0.101	0.920	1.252
Cooperation working style (CWS)	-0.013	0.069	-0.191	0.849	1.291
R	= 0.247				
R^2 (Adjusted R^2)	= 0.061 (0.025)				
F –statistic (p-value)	= 1.694 (0.157)				
Durbin Watson Statistic	= 1.420				

*Significance at 5% level

Table 5.0 presents the level of external auditor's reliance on internal audit based on their different positions. Current study attempts to investigate whether there are differences between managers' and senior executives' level of reliance on internal audit work.

Table 5.0: Crosstab Analysis on Manager and Senior Executive (By Rank) towards Reliance on Internal Audit Work

Reliance on Internal Auditor	**External Auditor's Rank**	
	Manager	Senior Executives
Low Reliance on Internal Auditor	13	20
High Reliance on Internal Auditor	25	14
Total	38	34

External auditors holding post assistant manager and above represented 35 percent (38 persons) of the total number of respondents. 31 percent (34 persons) of total respondents was represented by senior executives. Based on the crosstab analysis, the result indicates that 66 percent of the managers found that the assurance given by the internal auditor is useful and reliable. Therefore, managers place high reliance on internal auditors (scale 6 – 10). On other hand, a majority of senior executives (59 percent) rated that internal auditor work was less useful and less reliable This result in the senior executives placing low reliance on internal audit work (scale 1-5).

There are two justifications on external audit managers' high reliance on internal audit work. First, based on the survey instrument, it was clearly stated that the internal control and risk management of the company under review were highly established. There was also a clear reporting structure of the IAD which reported directly to the Audit Committee. These factors assured the external audit managers that the IAD was objective and not bias. In terms of quality of the internal auditors, it was stated in the questionnaire that all internal auditors possessed satisfactory auditing experience and four of them were Certified Internal Auditors (CIA). The auditors were also informed that one hundred percent of the internal audit procedures examined provided evidence of satisfactory instruction and supervision by senior internal audit personnel. Thus, the external audit managers were assured that the internal auditor work is of high quality. ISA 360 requires that external auditor reviews the work of internal auditors to give an assurance that the objectives of external audits have been achieved and conducted by internal auditors before relying on the internal auditors' work. Therefore, given the high level of assurance on the objectivity and competency of the internal auditors, the external audit managers based on their years of experience had chosen to place high reliance on internal auditors' work.

Secondly, most of the external audit managers were respondents from medium-size audit firms. The tendency of auditors from medium-size firms to rely on the work of internal audit is high compared to those from Big Firms due to limited resources. By relying on internal auditors' work, the medium-size firms can reduce the audit cost in terms of number of man days. The small to medium-size audit firms usually have limited expertise and auditors to perform pre-planning (risk assessment stage). Therefore, they will tend to rely on internal audit work to reduce the costs and to prevent external audit redundancy.

Conclusion

In conclusion, the result of current study suggests that external auditors' conflicts management style have a significant impact on external auditors' reliance on internal audit work. The results of current study could benefit various parties, especially management, internal auditors and external auditors. Company management will benefit by using the results as an indication that there is always a trade-off or substitution in the internal-external audit function. If the management decides to put huge investments in internal auditing (that is increasing the number of auditors, training hours, size of department), they can expect a reduction in the audit fees charged by external auditors.

Current study should also be beneficial to external audit firms by giving an indication of Malaysian individual auditors' conflicts management style. External audit firms should consider providing training on effective interview skills to inculcate auditor attitude towards "active working style" as well as to increase the level of professional skepticism. This is important to avoid having auditor with "passive working style" that lead to high reliance on internal audit work without proper evaluation of the quality of internal audit assertion.

In addition to individual working style, current study also investigates whether there is rank (Manager versus senior executive) effect on external evaluation to rely on internal audit work. The result contradicted those found by Brody (2012), where there was a reversed reliance decision made by both Manager and Senior Executive. The Managers (Senior Executives) have placed high (low) reliance on internal audit work. This is consistent with Moore (1993) who examined the similarity in internal and external audit risk assessment judgement. The study demonstrated that both internal and external auditors had similar judgements in the areas of internal control and objective assessment. Furthermore, Clark, Gibbs & Schroeder, (1980) found that external auditors expected less audit effort as a result of reliance on the internal auditors' work based on their knowledge of company operations, processes, and procedures.

Future researchers should consider extending the number of factors used in the model to fully explore the factors that might affect reliance of internal audits in Malaysia. In order to avoid such limitations, future study should be under the control environment such as an experiment. The samples should fairly represent audit firms of all sizes, which is from small to big firms. Future researchers can also expand the current research by including industries as an independent variable.

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Appendix

Conflicts or Problematics Relationship Between Management and External Auditor

No	Conflict
1	Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
2	Undue time pressures imposed by management to resolve complex or contentious issues.
3	Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
4	Unusual delays by the entity in providing requested information.
5	Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.
6	Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
7	An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
8	An unwillingness to address identified deficiencies in internal control on a timely basis.
9	Unwillingness by management to permit the auditor to meet privately with those charged with governance.
10	Accounting policies that appear to be at variance with industry norms.
11	Frequent changes in accounting estimates that do not appear to result from changed circumstances.
12	Tolerance of violations of the entity's code of conduct.