The Effects of Decreased User Confidence on Perceived Internal Audit Fraud Protection

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Abstract

This study uses data on user perceptions before and after Enron and other high profile frauds to explore how perceptions of the internal audit function were affected and to consider what, if any, response is appropriate. While internal auditors shared little blame for recent frauds, our results show a clear drop in user perceptions of the internal audit function irrespective of the structure of the function. This generalized effect likely stems from a general drop in confidence in the accounting profession.

Results also indicate that internal audit departments that report to senior management are perceived as less likely to prevent financial statement fraud than outsourced internal audit functions, even when the function is outsourced to the financial statement auditor. This finding implies that the SEC should consider more closely whether to regulate the relationship between the audit committee and the internal auditor. The internal audit profession may also take voluntary actions to enhance corporate governance and public perceptions.

Keywords: Internal audit; outsourcing; financial statement fraud; user confidence.

Data Availability: Please contact the first author for data availability.

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