

A Research Study about the Impacts of the Chinese Culture in the Practice of Internal Auditing in China

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Abstract

The internal audit function is a key managerial tool which can provide greater assurance to managers that one's organisation will succeed in achieving its objectives. However, there is a growing concern that internal audit practices should adapt different cultures and environments in order to be effective like for example in the fast-growing and emerging economy of China. This paper describes the preliminary research of a quantitative-based study which aims to explore how cultural differences influence the effectiveness of the practice of internal auditing in China from the following five aspects: the interrelations between the role of internal audit and the culture of the organisation in which this function operates, the social, organizational and cultural aspects in China and their impacts on the practice of internal auditing, the attitudes and behaviours of members of organisations in fulfilling their internal audit roles, and initiatives taken from individuals and organisations to adapt internal audit common practices from international standards in order to enhance the effectiveness of internal audit locally in China. Based on preliminary research results and professional experience from the author, suggestions are made for future improvement of the practice of internal auditing in China -from both local and foreign perspectives -, along with managerial discussions

Paper category

Internal auditing, Cross-cultural management, Control systems

1. INTRODUCTION

Following the Chinese economic reform started in 1980s, Foreign Direct Investment (FDI) has surged in China in the 1990s decade and beginning of 21st century. Several signals from the media and the international business community indicate that foreign companies are now currently judging that they have experienced 'difficult working conditions' in leading their operations in China since then. One the main reasons of this statement is that foreign companies have faced difficulties in implementing sound management practices in their operations in China in order to support business unit-level performance, among them poor internal control repeatedly comes up as one of the major reason for failing to successfully operate their business activities in China. The major concerns on poor internal control embrace such diverse areas as: quality management, the quality of financial (or non-financial) information for decision

making, cost control, leadership, or the strategic planning of the business activities for example. This paper describes the preliminary results of a research study exploring the reasons of this failure. Specifically the research aims at understanding the different ways organisations need to adapt their internal audit practices in China in order to make internal audit more effective in the cultural environments of China by (1) explaining the interrelations between the role of internal audit and the culture of the organisation in which this function operates, (2) identifying the impacting social, organisational and cultural aspects in China and (3) clarifying their impacts on the practice of internal auditing tasks, (4) understanding the attitudes and behaviours of members of organisations in fulfilling their internal audit roles in China, and (5) analysing a series of initiatives taken from individuals and organisations in China in order to adapt internal audit practices as compared to commonly accepted international practice.

2. A PRELIMINARY RESEARCH STUDY

Five aspects are discussed to understand how the cultural differences influence the managerial practice of internal audit in China: (1) the interrelation between the role of internal audit and the culture of the organisation in which this function operates, (2) the social, organisational and cultural aspects in China and (3) their impacts on the practice of internal auditing tasks, (4) the attitudes and behaviours of members of organisations in fulfilling their internal audit roles, and (5) initiatives taken from individuals and organisations to adapt internal audit practices as compared to commonly accepted international practice.

(1) The interrelations between the role of internal audit and the culture of organisations in China

Cultural differences have an impact on how organisations use managerial control tools in order to monitor organisational performance (Bourguignon, 2004). As a key managerial tool to manage performance by mitigating risks, the internal auditor needs to foster cooperative relationships, establish good communication and use interpersonal skills in order to carry out the different tasks of its job effectively. Due to his exposure to several organisational levels of the organisation including corporate and line management levels the internal auditor role is comparatively more affected than other functions by its capacity to liaise with other members of the organization (Chambers, 2001). Therefore the internal auditor would largely benefit from developing and

promoting a philosophy of coordination throughout the organization (Solomon, 2005). However this will depend on his capacity to interact and communicate effectively with members of his organisation at various levels in one way which is efficient in the context of the culture of the organisation. Guirdham (1994) has analysed the different styles of verbal and non-verbal communications in different cultures and how they affect the effectiveness of business communication. Beyond this, the societal role of the internal auditor himself is influenced by the social values of the organisation which might be impacted by country-specific social values. For example, in the Chinese culture relationships between members of one's organisation are primarily based on trust and teamwork rather than confrontation and monitoring (Kachelmeier, 1997) whereas the internal auditor's primary role is to report to management on internal control improvements to persuade to implement corrective actions. The independence criteria of the internal auditor's role claimed by *The Standards for the Professional Practice of Internal Auditing* also poses questions because the Chinese culture does imply individual behaviours which are more collectivist-oriented. Another consideration is the concept of risk which constitutes the background of the theory of internal control (COSO, 1992). Taking into account the differences in individual's attitudes to risks may also help to understand the impacts of cultural differences in a modern risk-based approach to the practice of internal auditing in China.

(2) The social, organisational and cultural aspects which impact the managerial practice of internal auditing in China

The cultural dimensions already evidenced in the cross-cultural management literature (Hofstede) provide a useful framework to identify how cultural differences may impact the practice of internal auditing. Power-distance requires that the internal auditor adopts a less-confronting, non threatening approach to internal auditing. The internal auditor should present his role in a non-exclusively managerial performance perspective, but in a more holistic perspective where employees can be rewarded according to their performance (principle of equity), equally (principle of equality), or based on their needs (Aguinis, 2002). Cultural differences imply different communication styles. In China, the internal auditor communication skills will need to adapt between low-context communication behaviours and high-context communication behaviours. In a high-context communication culture, individuals tend to minimise imposition to others and give priority to the maintenance of the other's face (Guirdham, 1994). Verbal communication in China should usually be more inclusive to the group and consensus-based. Differences in problem-solving way of thinking requires that the internal auditor should communicate findings and recommend solutions in a more contextual way.

(3) The impacts of cultural differences on the practice of internal auditing in China

The role of the internal auditor can also be seen from different angles as presented in different manuals on the

practice of internal auditing (Chambers, 2001). Firstly, we assume from the considerations stated above that the internal audit practice in China should differ from western practices by being more contextual and people-oriented (Lynton, 2006). On one hand Confucianism values imply that the internal auditor should aim to preserve the social harmony. In that perspective internal Audit in China can leverage on the role of consensus in assessing the level of acceptance of risks as expressed by *The Standards for the Professional Practice of Internal Auditing*. On the other hand internal audit can leverage from Chinese culture compliance gaining oriented behaviours which can provide the means to achieve greater acceptance of the audit recommendations. The consequence is that the capacity to combine consensus and authority along the audit process which requires strong interpersonal skills. Under the light of the cultural differences it becomes obvious that the preparation step of an internal audit project should require more attention in the Chinese culture because of its contribution to build trust and human relationships among individuals which is also reflected by the culture of 'guanxi'. The question remains however whether or not the dual role of the internal auditor being a controller or a consultant (Chambers, 2001) at some time can be practically effective in the context of the Chinese culture taking into account the asymmetric hierarchical relationships of management towards the employees based on authority and power. Secondly, the authority of the internal auditor to access information to complete the audit tasks interferes with the common belief in Chinese culture that information is sensitive and strategic therefore it should not be distributed to other parties without any authorisation and the definition of the responsibilities associated to the use of this information. Thirdly, in terms of reporting of the audit findings, some of the considerations stated above will imply that the internal audit report should not be discussed in a direct manner during the final meeting but would better follow different steps before the final discussion (Kagermann, 2001).

(4) The attitudes and behaviours from individual members of organisations in fulfilling their internal audit roles in China

An important factor affecting the implementation of internal audit functions and systems is attitude (McCornac 2006). From our research it can be observed from example that Control Risk Self Assessment reveal to be quite popular in China because they offer a more indirect, trustful relationship on monitoring internal control which is based on more informal communication and imparting knowledge. Several other common behavioural patterns can be observed which reflect how the internal audit profession adapts to the cultural environment of China as evidenced by research works *The Practice of Internal Auditing in Cross-cultural Teams in China* (InterauditAsia Management Institute, XXXX)

(5) The initiatives taken from individuals and organisations to adapt internal audit common

practices as compared to commonly accepted international practice in China

Several initiatives can be observed from current practices which demonstrate the ways the professional community attempts to adapt the practice of internal auditing to the cultural context of China. Companies in China may benefit from bringing more focus to operational auditing as compared to financial auditing in the internal audit function objectives (Yan Jin'e, 1997). From our research it can be observed that Control Risk Self Assessment reveal to be quite popular in China because they offer a more indirect, trust relationship on monitoring internal control which is based on more informal communication and imparting knowledge. However, it is essential to understand the company-specific culture of each organisation before formulating opinions on the way to adapt the practice of internal auditing to the culture of the organisation.

3. CONCLUSIONS AND SUGGESTIONS

The internal audit function is a key managerial tool to any organisation. The conclusion of our research is that the practice of internal auditing commonly accepted in Western countries can not be fully replicated in Asia and especially China due to significant cultural gaps which can greatly affect the effectiveness of the practice of internal auditing. The research currently conducted by the InterauditAsia Management Institute aims at identifying those impacting factors and analysing the emotional, cognitive and behavioural reactions from individuals in China based on a sample of companies from the private sector of reasonable size. Then the research paper explores the solutions which can be used to adapt the common practice to various contexts of Asian cultures. We hope that such solutions if implemented can provide great assistance to companies operating in China to enhance the practice of internal auditing in their operations locally, or on a more regional or global basis.

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APPENDIX

Research study on:

The Practice of Internal Auditing in cross-cultural Teams in China

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