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Assessing Management Integrity: Insights from Big 4 Auditors in Egypt

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SUMMARY: Recent corporate scandals have raised concerns about the quality and value of the audit profession and have generated demands for improving auditors' evaluation of management integrity. The literature lacks evidence regarding methods of assessing management integrity, while audit standards provide little if any guidance on this matter. This raises questions about how external auditors can comply with the audit standards in this area and what best practices and deficiencies exist in the assessment of management integrity. This study examines methods of assessing management integrity by providing insights from the Big 4 auditors in Egypt. The findings of this study will benefit audit firms in their professional audit training programs, as well as auditors conducting fraud risk assessments.

Keywords: audit quality; external auditors; fraud risk assessment; management integrity.

INTRODUCTION

The increasing number of corporate fraud cases has put more pressure on external auditors to improve their assessment of management integrity (Attard 2000; Petrick and Scherer 2003). The value of external audits is weakened when a client's integrity is questionable (Bernardi 2008; Jamal, Chen, and Luo 2014). Stakeholder's confidence in the independence of external auditors is strongly linked to their confidence in an auditor's ability to challenge management; unfortunately, this function does not seem to be one much expected of external auditors (FRC 2015). Therefore, improving auditor's skills in evaluating management integrity is crucial to reinforce stakeholder's confidence in the audit process.

The audit standards (ISA 240, IAASB 2009; SAS 99, AICPA 2002), while requiring external auditors to evaluate management integrity, provide no guidance on methods of assessing that integrity. This could have an impact on audit quality and the likelihood of detecting fraud. Emma, Okafor, and Ijeoma (2009) find that the evaluation of management integrity has a great impact on audit risk and that it is a critical part of developing an opinion on the fair presentation of financial statements.

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Audit standards act as benchmarks for ensuring audit quality. Therefore, the lack of guidance in this area could lead to great differences among audit firms in their fraud risk assessment methodologies and, in turn, their audit quality. Evidence from the literature indicates that inconsistencies do exist among audit firms in their fraud risk assessments (Shelton, Whittington, and Landsittel 2001; Hassink, Meuwissen, and Bollen 2010) and that auditors still need guidance in this area (Kassem and Higson 2012).

Research in this area focuses on the impact of management integrity (Rezaee and Riley 2010; Chen, Cumming, Hou, and Lee 2013; Rittenhouse 2015) while paying little attention to methods of assessing that integrity. This lack of evidence raises questions about how external auditors might comply with the audit standards in this area and what best practices and deficiencies exist in the assessment of management integrity. This study examines the methods of assessing management integrity by drawing on the experience of the Big 4 auditors in Egypt. The Big 4 auditors are known for their high audit quality (Eshleman and Guo 2014). Thus, the methods suggested by these auditors to assess management integrity may be regarded as best practices in the audit industry. External auditors in Egypt, particularly the Big 4, closely adhere to International Standards on Auditing (ISA), which may make the findings of this study generalizable to other contexts.

LITERATURE REVIEW

Assessing management integrity is an integral part of any audit. An underestimated perception of management integrity could lead to inefficient audits, while overestimation could lead to an overreliance on management's representations, which could result in ineffective audits and legal liability (Love and Manisero 2011; Maksymov 2015). Management integrity is the most important factor in an auditor's budget decisions (Blaskovich and Mintchik 2007) and in evaluating engagement risk (Ethridge, Marsh, and Canfield 2005). Management attitude and reactions toward the audit could give auditors an idea about management's level of integrity and could be a good indicator of fraud risk (Abdullatif 2013). Further, management staff who lack integrity are more apt to ignore policies and procedures to pursue their own self-interests. This practice increases the risk of fraud and abuse by management (Fuller and Jensen 2002).

External auditors are required to understand the client's internal control system and in particular the client's control environment. The control environment is key to evaluating management's integrity (Kizirian, Mayhew, and Sneathen 2005). This environment consists of the actions, policies, and procedures that reflect the overall attitude of top management about internal controls. This includes management's commitment to integrity and ethical values, commitment to competence, board of directors or audit committee participation, management's philosophy and operating style, organizational structure, and human resource policies and practices (COSO 2014). Weak integrity encourages unethical decisions and fraudulent behavior (Callaghan, Savage, and Mintz 2007; Rezaee and Riley 2010; Chen et al. 2013; Rittenhouse 2015).

RESEARCH METHODS

This study provides insights about the assessment of management integrity through questionnaires and semi-structured interviews of Big 4 auditors in Egypt. An online questionnaire was distributed to 150 auditors working in the Big 4 audit firms in Egypt, with 70 questionnaires returned (a response rate of 47 percent).¹ The questionnaire included a question seeking

¹ This percentage compares favorably with other studies that found the average response rate to questionnaire surveys in Egypt tends to range between 30 percent and 50 percent (Kamel and Elbanna 2009).

participants' consent to take part in a semi-structured interview related to the current study. Twenty-four participants agreed to take part in the interview. Fourteen interviews were conducted via Skype and ten interviews were conducted via Viber. Each interview lasted for approximately 30–45 minutes, and all interviewees agreed to have the interview recorded, except for one. Notes were taken in all cases during the interviews.² The data were analyzed using content analysis and SPSS. A summary of participants' demographic details is available, see Appendix A, Tables 1 through 4.

FINDINGS AND DISCUSSION

The findings reveal that the most commonly used methods (each mentioned 15 times) to assess management integrity include:

- (1) Inquiries of management and those charged with governance regarding fraud controls, past fraud cases, and how management dealt with them;
- (2) Open communication with employees regarding management's practices and ethical behavior;
- (3) Evaluating the company's code of ethics and the message it delivers to employees about management's tolerance of unethical behavior;
- (4) Understanding the extent of management's involvement in related-party transactions;
- (5) Conducting background checks on managers;
- (6) Checking if management had any financial statements restatements history; and
- (7) Asking the same question in multiple forms to determine whether a manager tends to hide information or falsify facts.

Use of "probing questions" during the interviews shows that external auditors use the following methods to conduct background checks:

- (1) Looking at management's *curriculum vitae* (cv) or personal websites;
- (2) Using Google search to check management's reputation in the market;
- (3) Looking up management's profile on the company's website; and
- (4) Conducting personal interviews with management to learn about their experience, qualifications, and educational background.

One interviewee said:

Management who has worked before at multinational companies tend to appreciate the impact of ethics on their companies' performance more than those who worked for local companies or government institutions.

Assessing management's commitment to ethical behaviors and values in an organization was mentioned 11 times. This supports the suggestions of [COSO \(2014\)](#) and [Callaghan et al. \(2007\)](#). The key to successful internal controls is having a control environment that sets a tone of integrity that influences the ethical and control consciousness of employees. Using probing questions during the interviews reveals that the following methods are used to assess management's commitment to ethical values:

- (1) Determining if management provides staff with ethics training or guides about acceptable ethical behavior;

² Relevant ethical approval was obtained prior to conducting this research.

- (2) Verifying whether there is a code of ethics published on the company's website;
- (3) Checking whether the code of ethics is communicated across the organization; and
- (4) Asking questions such as, "Does management lead by example and adhere to the company's policies and procedures?" "Does management impose any scope limitations on auditors?" And, "Does management treat employees fairly and with respect?"

This finding aligns with [COSO \(2014\)](#) in the importance of having a code of ethics and communicating ethical values to employees across the organization. It also supports [Fuller and Jensen \(2002\)](#), who pointed out that those executives who lack integrity tend to ignore policies and procedures to pursue self-interests. Thus, by asking if management adheres to a company's policies, external auditors could get an idea about management's level of integrity.

Observing and assessing management's attitude and reaction toward identified control deficiencies and audit adjustments, and its willingness to improve processes, were cited nine times. This finding agrees with [Abdullatif \(2013\)](#) that management's attitude toward the audit could be a sign of low management integrity and high fraud risk. One interviewee mentioned that:

Management's aggressive reaction to my questions about previous fraud cases and fraud controls made me question his integrity. By conducting deeper investigations, I have discovered management's involvement in assets theft.

Understanding and testing a client's internal control, especially the control environment, was mentioned five times. This finding agrees with [Kizirian et al. \(2005\)](#), who believed that the control environment is key to assessing management's integrity. One interviewee added that:

Integrity is a key factor in our assessment of the control environment using COSO framework. It can be assessed by asking employees at all levels about management integrity and whether they come across any risk factors that indicate management's lack of integrity. We browse global portals' knowledge links to get an idea about the company's history and whether management was involved in a fraud case before as part of our client's acceptance and continuance procedures.

For a summary of the findings, please see Appendix A, Tables 5 and 6. Table 6 shows the most to the least commonly suggested methods of assessing management integrity.

Content analysis was then used to determine whether auditors with different experiences and qualifications lean toward specific methods of assessing management integrity. The results of the analysis indicate that there is no noticeable difference in the methods suggested by auditors with varying years of audit experience. However, all auditors with a professional qualification in fraud examination (seven auditors held CFE credentials) tend to focus more on nontraditional assessment methods, including:

- (1) Management's attitude and reactions toward the audit and control deficiencies;
- (2) The existence of consistent misrepresentations in the financial statements that indicates management's intent to deceive;
- (3) Evaluating the code of ethics and the message it delivers about ethical values and integrity; and
- (4) Asking the same questions in varying ways to determine whether management tends to falsify facts.

This finding indicates that educating auditors about fraud could help them be more creative in their approach and perhaps design nontraditional audit procedures that could be more effective in

fraud risk assessment. This is supported by [Asare, Wright, and Zimbelman \(2015\)](#), who found that knowledge of likely fraud schemes and gaining forensic skills would help auditors in designing effective audit tests.

CONCLUSION

This study is the first to examine the methods of assessing management integrity by drawing on the experience of Big 4 auditors in Egypt. The guidance provided by this study could be useful to audit firms in their professional audit training programs and to auditors in their fraud risk assessments. The findings indicate that auditors having a qualification in fraud examination are more likely to design nontraditional audit tests that could help in effectively evaluating management integrity and assessing fraud risks. Future studies should explore other practices used by experienced external auditors in different contexts to assess management integrity.

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APPENDIX A

TABLE 1

Questionnaire Participants' Audit Experience

Big 4 Auditors' Experience	Frequency	Percent
3–5 years	20	28.5
6–8 years	20	28.5
More than 8 years	30	43
Total	70	100

TABLE 2

Questionnaire Participants' Professional Qualifications

Professional Qualification	Yes		No	
	Frequency	Percent	Frequency	Percent
Association of Certified Chartered Accountants (ACCA)	8	11.5%	62	88.5%
Certified Public Accountants (CPA)	50	71.4%	20	28.6%
Certified Fraud Examiners (CFE)	7	10%	63	90%
Egyptian Society for Accountants and Auditors (ESAA)	24	34.3%	46	65.7%

TABLE 3

Interviewees' Audit Experience

Audit Experience	Frequency	Percent
6–8 years	15	62.5
More than 8 years	9	37.5
Total	24	100

TABLE 4

Interviewees' Professional Qualifications

Professional Qualification	Yes		No	
	Frequency	Percent	Frequency	Percent
Association of Certified Chartered Accountants (ACCA)	8	33.3%	16	66.7%
Certified Public Accountants (CPA)	16	66.7%	8	33.3%
Certified Fraud Examiners (CFE)	7	29%	17	71%
Egyptian Society for Accountants and Auditors (ESAA)	20	83.3%	4	16.7%

TABLE 5
Participants' Methods for Assessing Management Integrity

Techniques	Frequency of Citation	Data Source
1. Inquiries of management, employees, and those charged with governance about fraud controls, past fraud cases, and how management dealt with them.	15	12 questionnaire participants and 3 interviewees
2. Communication with employees regarding their views on management's practices and ethical behavior.		
3. Evaluating the company's code of ethics in terms of the message it delivers to employees about management's tolerance of unethical behavior.		
4. Understanding the nature, timing, and extent of transactions with related parties and whether management is involved with any.		
5. During management's inquiry, try to ask the same question in different ways to determine whether management has a tendency to hide important information or to falsify facts.		
6. Conducting background checks on management to learn about their integrity and honesty.		
7. Checking if management had any financial statements restatements history.		
8. Assessing management's commitment to ethical behavior and values.	11	6 questionnaire participants and 5 interviewees
9. Assessing management's attitude and reaction toward identified control deficiencies and audit adjustments and their willingness to improve processes and reporting quality	9	2 questionnaire participants and 7 interviewees
10. Being aware of some of the following red flags: <ul style="list-style-type: none"> • Lack of an internal audit department • Management's ability to override the internal control system (mentioned four times) • High turnover of senior management (mentioned three times) • Lack of a code of ethics (mentioned five times) • Lack of a whistleblowing hotline (mentioned three times) • The existence of internal control weaknesses such as improper disclosure, improper authorization, and lack of adequate segregation of duties (mentioned six times) • The existence of unreasonable acts/behavior by management • The existence of consistent misrepresentations of the financial statements and the frequency of misstatements (mentioned six times) 	8	3 questionnaire participants and 5 interviewees

(continued on next page)

TABLE 5 (continued)

Techniques	Frequency of Citation	Data Source
<ul style="list-style-type: none"> • The existence of unrealistic budgets that were difficult to achieve but were yet achieved by management or unexplained budget variances • The existence of litigations against management or the company • Management or employees are dealing in gambling businesses or are gambling for leisure • The use of aggressive accounting policies • The existence of unexplained transactions outside the normal course of business 		
11. Understanding and assessing the client's internal control system	5	5 questionnaire participants
12. Considering whistleblowing hotline for tips about management's integrity to understand the procedures taken by the company to protect whistleblowers and to determine how complaints are dealt with	5	2 questionnaire participants and 3 interviewees
13. Understanding human resources policies and procedures, especially the process of conducting background checks on management and employees	5	2 questionnaire participants and 3 interviewees
14. Checking if there is a previous history of management's involvement in fraud cases	4	2 questionnaire participants and 2 interviewees
15. Assessing the risk of management override of internal controls	3	3 interviewees
16. Review previous year audit reports or contact previous auditors to determine whether management had any issues with the previous auditors and to determine the degree of previous auditors' reliance on management's integrity	2	2 questionnaire participants
17. Assess the company's policy for conflicts of interest, related-party transactions, and disclosure	1	1 questionnaire participant
18. Inspecting management's disclosure in the financial statements to determine management's tendency to hide important information	1	1 questionnaire participant
19. Inspection of board of director's minutes of meetings	1	1 questionnaire participant
20. Communication with the company's lawyer to see if there are any lawsuits against the company	1	1 interviewee

TABLE 6
How to Assess Management Integrity
A Guide to External Auditors

1. Ask management, employees, and those charged with governance about fraud controls, past fraud cases, and how management dealt with them
2. Ask employees about management's practices and ethical behavior
3. Evaluate the code of ethics and the message it delivers to employees about management's tolerance of unethical behavior
4. Understand the nature, timing, and extent of related-party transactions, and the extent of management's involvement
5. Ask management the same question in different ways while inquiring about the company's controls, fraud cases, and operations to determine if it has a tendency to hide information or falsify facts
6. Conduct management background checks to learn about their integrity by:
 - Knowing about managers' educational background and experience by looking at their personal website, CVs, or by asking them
 - Using Google search to check management's integrity history and reputation in the market
 - Following the news or media
7. Check if management had any financial restatements history
8. Assess management's commitment to integrity and ethical values by determining whether:
 - Management imposes scope limitations on auditors
 - Management provides staff with ethics training or guides about acceptable ethical behavior
 - There is a code of ethics on the company's website
 - Management leads by example and adheres to the company's policies and procedures
 - The code of ethics is communicated to employees and management at all levels
 - Management is willing to do the right thing
 - Management cooperates with auditors
9. Observe and assess management's attitude and reaction toward identified control deficiencies and audit adjustments, and its willingness to improve processes and reporting quality
10. Be aware of the following red flags:
 - The existence of internal control weaknesses such as improper disclosure, improper authorization, and lack of adequate segregation of duties
 - The existence of consistent misrepresentations of the financial statements and the frequency of misstatements
 - Lack of a code of ethics
 - Management's ability to override the internal control system
 - High turnover of senior management
 - Lack of a whistleblowing hotline
 - Lack of an internal audit department
 - The existence of unreasonable acts/behavior by management
 - The existence of unrealistic budgets that were difficult to achieve but were yet achieved by management
 - The existence of unexplained budget variances
 - The existence of litigations against management or the company
 - Management or employees are dealing in gambling businesses or are gambling for leisure
 - The use of aggressive accounting policies
 - The existence of unexplained transactions outside the normal course of business
 - Scope limitations imposed on auditors

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TABLE 6 (continued)

11. Understand and assess the client's internal control system while focusing on the control environment and control activities, especially the lack of adequate segregation of duties and proper authorization of transactions
 12. Consider whistleblowing hotline for tips about management integrity, understand the procedures taken by the company to protect whistleblowers, and determine how complaints are dealt with
 13. Understand human resources policies and procedures, especially the process of conducting background checks on management
 14. Check if there is a previous history of management's involvement in fraud cases
 15. Assess the risk of management override of internal controls
 16. Review previous year audit reports or contact previous auditors to determine whether management had any issues with previous auditors and to determine the degree of previous auditors' reliance on management integrity
 17. Assess the company's policy for conflicts of interest, related-party transactions, and disclosure
 18. Inspect management's disclosure in the financial statements to determine management's tendency to hide important information
 19. Inspect the minutes of board meetings to determine whether management is engaging in unacceptable practices and how it deals with ethical issues
 20. Ask the company's lawyer about lawsuits against the company or its management
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