

Risk Communication in the Context of an Internal Audit

Insights from a Behavioral Risk Perspective

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Abstract

In their exercise of occupation, internal auditors are regularly confronted with the necessity to evaluate risks, for example in order to establish an audit plan or during the audit itself. In this specific context, it is of exceptional importance to understand which variables are important in explaining human risk perception, as specific risk characteristics and/or the manner of risk information presentation can have a significant impact on the magnitude of the perceived risk. Only with the knowledge of the variables which explain human risk perception, it is assured that risks are communicated reliably, i.e. without inducing either unexpected or – for example in a case of fraud – misguided behaviors. To fulfill the purpose of this study, we introduce two theoretical approaches for which scholars argue that the variables which underlie the approaches influence people's perception of risks: While the decision theory view proposes that risk judgments are based on probabilities and potential outcomes, the behavioral risk perspective suggests that the perception of risk is rather captured by variables such as to what extent a risk is controllable or causes worry.

We extend previous research by developing a structural equation model which includes both sets of variables as determinants of risk perception. This approach also allows us to explicitly model interactions between the sets of variables. For the empirical validation of our model, we make recourse to data derived from an experimental-style survey that was conducted with 32 students who were asked to assess five risks which the fictitious "Alpha group" disclosed. The information assessed by the participants of our study thereby resembles information that might be assessed by internal auditors in order to establish an audit plan or during the audit itself. The generated results of our study suggest that both described approaches are important in explaining human risk perception and that consequently both sets of underlying variables significantly influence the magnitude of the perceived risk. These findings can for example help to develop guidelines for internal auditors on how to assess information about risks in order to avoid inadequate responses to a disclosed risk, for example as a result of an under- or overestimation of the respective risk.

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