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Effectiveness of Internal Audit: Ensuring Public Sector Accountability and Integrity

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ABSTRACT

Good governance in public administration does have the positive impacts to the public. Government practices and implements good service delivery because they want to uphold the status of public servant as it is the main obligation of government to serve the best to the public. These activities are monitored by the internal audit to achieve accountability and integrity, to improve the implementation of government programs and to develop confidence among citizens and stakeholders as well as to cater to any risk of mismanagement of public fund. This paper focuses on reviewing the previous literatures in determining the determinants in assessing the effectiveness of internal auditing process in the public sector. Therefore, this paper uses secondary data in gathering the information relating to the internal audit to accomplish the objectives of this study. This paper further expands and develops the literature on the role and effectiveness of internal auditing to enhance public sector accountability and integrity. Eventhough the paper is conceptual, but it also concludes the factors that contribute to the effectiveness of internal audit. Therefore, this study finds that the effectiveness of internal audit in public sector can be measured through several factors such as auditors' competency, independence of internal auditor and management support to the role of the internal auditor.

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1. Introduction

There are two core elements which influence good governance, namely: accountability and integrity. The accountability and integrity of the auditors should not be underestimated because their role is to improve the organizational efficiency and effectiveness through constructive criticism (Goodwin-Stewart & Kent, 2006). Integrity is defined as a quality of excellence that is manifested in a holistic and integral manner in individuals and organizations. Integrity is based on ethics and noble values (National Integrity Plan, 2004). It stimulates employees to comply and helps to instill values that support a commitment to ethical product. Therefore, integrity system is very important to ensure accountability and transparency within the organization (Aziz, Rahman, Alam & Said, 2015).

Accountability is often associated with concepts such as answering, responsibility, blameworthiness, liability and other terms associated with the expectation accounting (Ahmad Faiz et. al., 2009). Accountability implies that the organization that conducts the affairs of society through the management of public funds ensures the realization of human rights in a way free of abuse and corruption and abide by the rule of law (Aziz et. al., 2015)

Internal Audit (IA) is perceived as one of the important factors to enhance the accountability and integrity in public sector. The internal audit's main objective is to assist the government to achieve thorough public financial and operational management through effective public spending accountability and transparency (Amanuddin, Divyaa, Kanagambikai, Shameene & Shameni, 2014). IA will enhance public accountability as well as enable more economical, efficient and effective utilizing of public resources (Chew, Suhaiza & Fatima, 2014). In addition to that, audit services can help the organization for the success of better financial management in public services by playing the effective and efficient role to promote better governance in managing public money (Zulkifli, Alagan & Mohd, 2014).

Government conducted and implemented internal audit in terms of financial and performance audit to detect irregularities that occurred in public sector. The performance audit carried out on programmes and activities showed that the Federal Statutory Bodies had good planning of projects and activities. The former Auditor-General Tan Sri Ambrin Buang said 180 ministries, departments and federal government agencies received Excellent (5-star) ratings compared to only 114 in 2014. "In order to facilitate corrective actions and improvements by the relevant Department Heads, the National Audit Department has submitted 78 recommendations to the Federal Government, Federal Statutory Bodies (43) and the State (181) to improve their weaknesses (AG's Report 2015: An Excellent Financial Performance by Govt Agencies, 2015)

However, in terms of implementation, there were several weaknesses that need to be addressed immediately to ensure the implementation of each programme and activity was carried out in an efficient, economical and effective manner so as to achieve their stipulated objectives. Some agencies had already taken corrective actions after weaknesses were highlighted by Audit. Nevertheless, corrective actions should be taken continuously. As auditing was performed based on sampling and on limited scope, a check and balance system should be established by the Chief Executive Officers to ensure that a thorough examination was carried out. This was to assess whether other projects and activities had similar weaknesses so that corrective actions could be taken and improvements could be made. This was necessary to ensure all agencies implement their projects and activities in a timely manner and obtain the best value for money. (National Audit Department, 2015)

Despite of having good internal audit control regulations, the finding of Auditor- General's Report 2016 Series 1 still contained findings on negligence, indiscipline, corruption and misconduct among civil servants. The problems identified would negatively reflect on the effectiveness of the internal audit department of the public sector. The main objectives of this study are to examine and analyze previous studies to determine the factors that influence the effectiveness of internal audit in the public sector. This study could assist policy makers to establish more accountability and integrity in public sector. This study also presents a research direction for further work for the future researchers.

2. INTERNAL AUDIT IN PUBLIC SECTOR

The issues of globalization, corruption, lack of integrity and transparency and poor public service

delivery increase the need for good governance and accountability. Thus, these problems lead the interest to the internal audit functions in the organization. Goodwin (2004) claimed that public sector internal audit functions have a higher status than private sector. However, with the latest global economic meltdown and the increasing fraud cases, the internal audit functions are becoming vital in both private and public sectors (Amanuddin, S., Divyaa Bharathii, Manijegar; Kanagambikai, Kirupanangtan, Shameene, Rahman; Shameni, Selvanathan, 2014). The cases reported surely must be a great concern to the government.

The authority for establishment of Internal Audit departments in public sectors in Malaysia was initially made possible through Treasury Circular Ref. 2 of 1979 (Perbendaharaan Malaysia, 1979) under the title of the Implementation of Internal Auditing in Federal Government Agencies. This circular was replaced by Treasury Circular Ref. 9 of 2004. : Implementation of Internal Auditing in Federal Ministries and Departments and State Governments (Perbendaharaan Malaysia, 2004). This particular circular extended the requirement of establishing internal audit unit to all Ministry, Department and State Government level and to agencies and departments in the State Governments. The circular also highlights the roles and responsibilities of the Internal Audit department, the secretary-general and the Treasury and provides direction on the implementation of Internal Audit.

The circular has been improved and replaced by 1 Treasury Circular No. PS 3.1/2013 under the title Implementation of Internal Audit Unit at Ministry/Departments of Federal Government and State Government. The main objective of IA as specified under this circular is to assist public sector in evaluating and determining the effectiveness of all internal control processes and governance of the organization to achieve it established goal.

Generally the internal audit unit is responsible for conducting audits of financial management and performance audits. The financial management audit includes examination of financial systems, internal controls and financial records to determine whether expenses, revenues, assets and stores have been handled in accordance with the laws, regulations and instructions. While performance audit includes assessing the activities of an organization to define if its goals have been achieved and the resources have been used in a prudent, efficient and effective (Perbendaharaan Malaysia, 2004).

In addition to internal auditing, public sectors are also subjected to the external auditing which is carried out by the Auditor General. This is a statutory requirement where the Auditor General derives his powers and responsibilities from the Federal Constitution and the Audit Act, 1957. It should be noted that the reports of the Internal Audit departments are presented to the secretary generals of ministries and director generals/board of directors of agencies, whereas the Auditor General's reports are required by law to be presented to Parliament at the Federal level and to the state legislative assembly at the state level for tabling. Once the reports are tabled, the Public Accounts Committee takes over for follow up action on the Auditor General's findings.

The Institute of Internal Audit (IIA) has defined IA effectiveness as "the degree (including quality) to which established objectives are achieved" (Institute of Internal Auditors, 2010). Badara & Saidin (2013) define internal audit effectiveness as 'the ability of achieving established objective within an organization' internal audit effectiveness is essential in the objective achievement of an organization and in line with this, any organization whether private or public should make sure that their internal audit is effective so as to achieve their objective in an efficient manner (Badara & Saidin, 2013) Nevertheless, Unegbu, A.O & Kida, M. I.(2011) state that the Internal audit can effectively check fraud and

fraudulent activities in the public sector. From the above definition, internal audit effectiveness can be classified as the auditors achieving the objectives that has been set up by each levels in public sector.

Internal Audit (IA) is perceived as one of the important factors to enhance the accountability and integrity in public sector. The internal audit's main objective is to assist the government to achieve thorough public financial and operational management through effective public spending accountability and transparency (Amanuddin,S. et. al, 2014). IA will enhance public accountability as well as to enable more economical, efficient and effective utilizing of public resources (Chew et. al., 2014). In addition to that, audit services can help the organization for better financial management in public services by playing an effective and efficient role to promote better governance in managing public money (Zulkifli et. al., 2014).

Different study yield different findings about the effectiveness of internal audit. Alzeban and Gwilliam (2014) investigated the factors influencing the effectiveness of internal audit in the Saudi Arabian public sector. The outcome of the study indicates that both managers and internal auditors perceived internal audit to be performing its task as expected. This is evidenced by internal audit review of the adequacy of the internal control system; review of the accuracy of financial report; review of compliance with policies and procedures; safeguarding the properties of the organization, and recommending improvement of established internal control system.

Abuazza et al. (2015) investigated the scope of internal audit function in public enterprises operating in Libya. The finding of the study indicates that the extent of internal audit task is concentrated and restricted to traditional audit relating to the financial matter. The study finds a little concentration of internal audit task on risk, effectiveness, and efficiency of various aspect of the enterprises.

Christopher (2014) also examined internal audit functions and how they enhance university sector governance in Australia. The finding of the study revealed that the universities in Australia have internal audit charter which empowered IAD to perform its task as required. Consequently, the result of the study further showed that the performance of internal audit was effective, and the department covered a broad range of audit tasks consisting of a financial audit, operational audit, performance based audit, compliance audit, IT audit, fraud audit, and consultancy type of audit. Hence, internal audits in Australian universities add value through their effective and efficient task performance.

3. FACTORS THAT CONTRIBUTE TO THE EFFECTIVENESS OF INTERNAL AUDIT IN PUBLIC SECTOR

There are very few academic studies on the effectiveness of the internal audit function (Cohen & Sayag, 2010), with relatively little research in public sector. Chevers,, Lawrence, Laidlaw & Nicholson, (2016) investigated the factors that influence the effectiveness of internal audit function in Jamaican commercial banks and subsequently found that quality of audit investigation, organisational independence, professional proficiencies and management support have significant impact on internal audit effectiveness.

Chevers, et. al (2016) , Badara and Saidin (2013) suggest that future research could be conducted on the effectiveness of internal audit in other sectors, both public and private. In addition further study should concentrate on the examination of other factors that contribute to internal audit effectiveness

which were not included in this study.

The effectiveness of internal audit in public sector can be measured through several factors such as auditor's competency, independence of internal auditor and management support to the role of internal auditor (Zulkifli, Alagan, & Mohd, 2014). A study by Cohen and Sayag (2010) evaluates the effectiveness of internal auditor by professional efficiency of internal auditors, quality of audit work, organizational independence, career and advancement and top management support. The finding shows that the correlation and regression analyses show support from top management to be the main determinant of IA effectiveness, with some effect also found for the organizational independence of IA.

This paper focuses in the reviewing previous literature in assessing the effectiveness of the internal auditing process in the public sector. Hence, the secondary data were used in gathering the literature through library searches. The secondary data include the information collected by the government departments such as circulars and journal articles. The secondary data are very useful for understanding and providing the foundation of the internal audit matters.

3.1 Auditors Competency

Competency is the ability of an individual to perform a job or task properly based on the educational level, professional experience, skill and attitude of the auditors. Mihret and Yismaw (2007), concluded in their study that IA office constantly faces the problem of low technical staff proficiency and high staff turnover, which would limit its capacity to provide effective service to the management. Competency can be related to the ability of an individual to perform task based on the educational level, continuous development and professional experience. It determines the efficiency of auditor to evaluate and improve the effectiveness of the organization's activities and operations. In order to achieve competency, various types of training and development should be provided to internal auditors. A competent internal auditor will have all the skill necessary to produce a good audit report. A certified auditor is able to make a good decision in the fastest time without having to wait or to consult with another team (Al-Matari et al., 2014).

In addition, Unegbu and Kida (2006) has found in their study that IA could carry out their duty in the public sector more effectively if there are enough IA personnel with required competencies. Competency determines the efficiency of the auditor in setting a systematic and disciplined approach to evaluate and improve the effectiveness of the organization's activities and financial management as well as governance processes (Zulkifli et. al., 2014). Findings from the study done by Amanuddin et. Al. (2014), from the interviews conducted on internal auditors from three government ministries indicated that competency of internal auditor is very crucial in maintaining the effectiveness of public sector internal audit. Training and development and knowledge of internal auditors are the main keys towards an effective audit committee. An auditor without sufficient knowledge cannot be trusted in producing a good audit report.

3.2 Independence of Internal Auditors

The independence of internal audit is crucial for the success of their functions to enable them to conduct audit activity without the interference of any party. For internal auditors, the audit activity should have sufficient independence from those they are required to audit so that they can both conduct its work without being bias and in dilemma in performing their duties. George, Theofanis

and Konstantinos (2015) said that independence is assessed with regard to the internal audit's report to the highest level, the unrestricted access of internal auditors and the performance of internal audit in the development of the company's process.

However, in certain situation, the stakeholders can argue the independence of IA. This could affect the effectiveness of internal auditing as even though internal auditors are charged with upholding the best interests of their employer, they may be reluctant to counter management, regardless of the consequences (Zulkifli et. al., 2014) The internal auditor may face independence issue as they are the staff of the organization, however the external auditor from National Audit Department do not face these problems as they report directly to the Auditor General (Amanuddin, S., et al, 2014). The internal auditor effectiveness is very much affected by the independence of internal auditors. If the internal auditors are not independent, the report they produce will be biased which in turn is useless in improving the accountability and transparency of the public sector as a whole. The objective and independent report produced by the internal auditor is one of the main keys to prevent scandals and frauds happening in the public sector. In fact, this is the main reason the internal audit function is set up in the ministry in the first place (Amanuddin et. al., 2014).

Cohen and Sayag(2010) in their study claimed that it can thus be argued that organizational independence will increase the internal auditor's effectiveness. This independence both lessens the conflict between loyalty to the employer and loyalty to specific managers, and gives auditors a supportive work environment in which they can conduct their tasks objectively and without pressure. Eleven items measured this variable (Cohen and Sayag, 2010) that consist of (1) I have regular and direct working relations with the head of the IA committee; (2) I have regular and direct working relations with the general manager and the managerial team; (3) Terminating the work of the IA requires the approval of the IA committee, and/or the board of directors, and/or the Civil Service Commission; (4) The IA staff has free access to information and data about the organisation, and unrestricted access to its site; (5) All organisational data pools are accessible to the IA; (6) All organisational data pools can be downloaded and examined by the IA;(7)Detailed budget proposals and information on staffing are included in the annual work plan of the IA; (8) I rotate the IA staff so that they all cover a variety of assignments; (9) The IA also perform activities even if they are not defined as its direct responsibility; (10) The IA sometimes takes part in designing systems in the organisation and in developing procedures for regulating their operations; (11) The IA operates totally independently, can audit any issue it considers in need of auditing, and can access any necessary information even if it is classified.

Alzeban, A., & Gwilliam, D. (2014) states in their paper that independence of IA measured based on (1) Internal audit staff are sufficiently independent to perform their professional obligations and duties (2) The head of internal audit reports to a level within the organization that allows the internal audit to fulfil its responsibilities (3) The head of internal audit has direct contact to the board (to the President for Government Organizations) (4) The internal audit department has direct contact with senior management other than the finance director (5) Conflict of interest is rarely present in the work of internal auditors (6) Internal auditors rarely face interference by management while they conduct their work (7) Internal audit staff have free access to all departments and employees in the organization (8) The board of directors (the President for Government Organizations) approves the appointment and replacement of the head of internal auditing (9) Internal audit staff are not requested to perform non-audit functions

3.3 Management Support to the Roles of IA

The support and cooperation from the management will contribute to the success and failure of the effectiveness of IA. The management must disclose and declare if something unusual occurs in the organization. It is because if this problem is not solved and managed from the beginning, the situation will be worsened thus will give bad impact to the organization's reputation and profitability. The activities of internal auditors will be challenging given the lack of top management support (Mebratu, 2015).

Ali, Gloeck, Ahmi and Sahdan(2007),in their study on IA in the state and local government of Malaysia found that, the effectiveness of the IA function in State and Local Government appears to be directly related to the management style of organization heads and their links, relationships and position in the social contract. Some IA functions appear to be doing well, the determining factors appear to be the attitude and leadership qualities of the head of an organization and audit reports that are ignored by everyone. Dellai and Omri (2016) who examined the factors influencing internal audit effectiveness in Tunisian context revealed that without top management support, internal auditing is not sufficiently objective and independent, has not enough resources to effectively fulfill its works, cannot hire proficient IA staffs and internal auditor cannot develop the professional careers. Alzeban, A., & Gwilliam, D. (2014) states that management support is measured based on (1) Senior management supports internal audit to perform its duties and responsibilities (2) Senior management are involved in the internal audit plan (3) Internal audit provides senior management with sufficient, reliable and relevant reports about the work they perform and recommendations made (4) The response to internal audit reports by the senior management is reasonable. Internal audit department is large enough to successfully carry out its duties and responsibilities (5) Internal audit department has sufficient budget to successfully carry out its duties and responsibilities

Management support for IA is thus important both in the abstract (managers must see the activity of the audit department as legitimate) and in ensuring that IA departments have the resources needed to do their jobs (Cohen & Sayag, 2010).Dellai and Omri (2016) who examined the factors influencing internal audit effectiveness in Tunisian context revealed that without top management support, internal auditing is not sufficiently objective and independent, has not enough resources to effectively fulfill its works, cannot hire proficient IA staffs and internal auditor cannot develop the professional careers.

4. DISCUSSION AND RECOMMENDATION

Based on the previous study there are some connections between accountability and integrity with the effectiveness of internal audit. The main factors that contribute to the effectiveness of IA are auditor's competency, independence of internal auditor and management support to the role of internal auditor. This study not only contributes to the body of knowledge theoretically, but also in practices. Results from this study could be useful to policymakers, educators, administrators and staff as they work to evaluate/ audit programs in preparing and maintaining a high-quality process and procedures in public sector. Having a clearer understanding of how IA impact the organizations performance and their work, within a national context, may help them reconsider the ways in which they prepare the people or public in general to do in the 21st century. It may also provide insight into what these reforms mean to staff and what impact they may have in an organization especially in public sector. For future studies, the researcher should consider other factors which influence effectiveness. By identifying the factors of effectiveness of IA, it may contribute for deeper understanding of IA for an increase in

the development of knowledge in internal auditing areas and to maximise government's performance, rendering support for the development and stringent economy and to increase and develop the awareness of the public about the importance of IA.

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