Assessing Efficiency in Public Organizations: The Role of the Internal Audit Function

A Dissertation submitted
to the Graduate School
Valdosta State University

in partial fulfillment of requirements
for the degree of

DOCTOR OF PUBLIC ADMINISTRATION

in Public Administration

in the Department of Political Science
of the College of Arts and Sciences

May 2017

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ABSTRACT

The growth and evolution of the Internal Audit Function (IAF) into management's partner in navigating the risks and opportunities of today's global political economy cannot be understated. Internal auditors play a critical role in assessing, identifying, and helping management mitigate the many risks that may hinder an organization from achieving its objectives. With divergent skills and a focus on adding and preserving value, IAF has been an independent adviser to management on everything from fast changing technology and new markets to compliance with global regulations.

The intent of this study is to review the impact of IAF on public organizations. It aims to use quantitative information to contribute to the literature on the effect of the internal audit on the efficiency of programs and processes within organizations. Previous studies have mostly concentrated on the qualitative persuasion of measurement, but this study will also include quantitative information as a means of deepening the understanding of the political, social, and most importantly the financial benefits that accrue to public organizations as a result of audit recommendations made by IAF. Quantitative acceptance and implementation percentages, as well as projected savings that accrue from IAF's recommendation, were used to calculate the IAF's financial effect on public organizations.

The information contained in this study explains the importance of IAF and supports the hypothesis that IAF has a positive impact on the efficiency and effectiveness of organizational activities and on the reduction of fraudulent activities through the financial and operational savings attributable to IAF recommendations. The statistical analysis will show that IAF activities have a positive correlation with the increased efficiency of public organizations.

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Accountability	Obligation to explain, justify and take responsibility for conduct
Add Value	Audit work that helps management improve the business operations
Agency Theory	The theory that attempts to explain the relationship between agents and principal
Agent	Entity or person delegated to use and control the resources of a principal
Internal Audit	Employed by the organization to conduct assurance and consulting activity designed to add value and improve an organization's operations.
External Audit	Contracted by organization solely to report on the fair presentation of the financial statements
Assurance	An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization.
Chief Audit Executive	Person responsible for managing the internal audit activity of an organization
Compliance	Adherence to policies, plans, procedures, laws, regulations, contracts, or any other requirements
Consulting	Advisory and related client service activities intended to add value and improve an organization's governance, risk management and control processes
Control	Action taken by management to manage risk and improve the likelihood that objectives and goals will be achieved
Efficiency *Engagement*	The optimal use of resources to produce intended results IAF assignment, task or review activity
Fraud	Any illegal act characterized by deceit, concealment, or violation of trust
Governance	The combination of processes and structures implemented to inform, direct, manage and monitor the activities of the organization
Independence	Freedom from conditions that threaten the ability of IAF to carry out its responsibilities in an unbiased manner
Internal Audit Function	Provides independent, objective assurance and consulting services to an organization
Linear Regression	Use of the values from an existing data set consisting of measurements of the values of two variables, X and Y, to develop a model that is useful for predicting the value of the dependent variable, Y for given values of X
Management	Persons charged with controlling and making decisions for an organization
Principal	Owner of the resources who delegates control to an agent
Qualitative	Data that can be observed but not measured
Quantitative	Data that can be measured
Risk	The possibility of an event occurring that will have an impact on the achievement of organizational objectives

Risk Management	Process of identifying, assessing, managing and controlling risks to provide reasonable assurance regarding the achievement of organizational goals
Standards	Pronouncements promulgated by a professional body that delineates the attributes and requirements for members of the profession on the execution of their responsibilities
Transparency	Openness to information on how officials conduct public business and spend taxpayers' money

ACKNOWLEDGEMENTS

Thanks to the most high for bringing me to this point of this journey and what a journey it has been! From a kid who alighted an airplane in a foreign country with only a backpack and a dream, I have come to the place I am today.

I want to recognize the late Mr. Charles Anderson who was not only a personal friend but also my IAF mentor. I also want to thank my work family at the Osceola County Office of Commission Auditor for putting up with me and especially Damiana Pache who dared me to venture down this path.

Thanks to the Association of Local Government Auditors for working with me in collecting the data for this study. Niki Raggi and Andrew Keegan – you rock!

To all my friends, too many to mention, who cheered me on, you guys are the best; and finally,

I cannot say enough about my entire family for sticking with me through it all. Words cannot adequately convey the love I have for you.
My wife, IK: you are the best,
My kids: thanks for sharing me with VSU for the last three years,
My siblings: Maama, Stan and Oby, if I am reincarnated, I want you guys as siblings.

DEDICATION

This study is dedicated to my parents, the late Mrs. Lucy Elekwuizu Nwachukwu and the late Mr. Chukwuemeka Ezekiel Nwachukwu who instilled in me and my siblings the thirst for knowledge.

I love you both.

Chapter I

INTRODUCTION

The public sector performs complex tasks in an economic climate that require the public sector to do more with less (Bouvard et al., 2011, p. 1). Coupled with a global marketplace that consists of breathtaking changes, rapidly changing information technology, knowledge based economy and niche markets (Osborne & Gaebler, 1993, p. 15) it is imperative that institutional flexibility, responsiveness, adaptability, and most importantly accountability be adopted in all projects and processes if efficiency is to be achieved.

In order to fully appreciate the importance of effectiveness in the public sector, it is necessary to consider the concept of publicness and the significant role public organizations play in everyday life. Public organizations (Bozeman & Bretschneider, 1994, p. 199) are described as those charged with operating in the interest of the public or with responsibilities to provide goods and services with public goods characteristics. While this may suffice for the theoretical explanation of the differences between public and private organizations, practice does not provide an empirical test of the delineation. Bozeman (2011, p. 365) argued that the publicness and privateness of organizations are constrained by political and economic authorities which makes it difficult to solely identify with one category. Both exercise and are constrained by political and economic authorities to an extent, but public organizations possess the presence of democratic accountability, production of collective goods, and due process. The difficulty of measuring the publicness of organizations is highlighted in the intermingling of activities provided by both private and public organizations, which requires public funding and control (Bozeman, 2004, p. 30). Provision of public goods and services through contracts with private organizations further convolute the delineation of public and private organizations. Although Bozeman and Bretschneider (1994), Bozeman (2013) and Rainey, Backoff, and Levine (1976) all identify with the ambiguity of classifying publicness in organizations because of the overlap in their purposes and design, this paper will consider the three dimensions of ownership, funding, and control, as a determinant of publicness and will analyze data gathered from organizations that exhibit those characteristics. Some scholars, according to Rainey (1983, p. 213) theorize that ownership and funding by government, control by a number of external entities, and the pressures of accountability are tantamount to publicness of an organization. The legal and formal environments (Bozeman & Bretschneider, 1994, p. 200), as it relates to the autonomy and flexibility of the organizations are also factors to be considered when trying to determine if an organization is private or public. Organizations that have their purposes and activities (Rainey et al., 1976, p. 238) defined by law; are subject to hierarchical and bureaucratic external control (Rainey, 1983, p. 209); and are influenced by political fluctuations are largely considered public.

The management of the public sector has an effect on everyday life without regard to age, sex, ethnicity, religion, or location. Because of this, it is important that the services the public sector provides are delivered effectively and efficiently. Bartlett (2009, p. 7) posits that “combining efficiency (doing things right) with effectiveness (doing the right things) is a duty for every government.” Unlike the business sector that can generate its income stream from sale of goods and services in the marketplace (Mikesell, 2014, p. 2), the nature and value of the goods and services provided by the public sector is such that it cannot be captured in a voluntary sales transaction. This paper discusses and analyzes how IAF in the public sector has evolved to become an important function in ensuring the equitable production and distribution of public goods. It measures the effect of IAF on the efficiency of public organizations in delivering public goods.

IAF plays a very important role by ensuring that public sector government fulfils the charge thrust upon it as the guardian of citizen's trust and funds. IAF's independent and unbiased assessment of public resources assist management in making strategic organizational decisions geared towards the achievement of organizational goals. With the crisis of confidence abundant in today's public sector (Mueller et al., 2015, p. 1172), IAF serves to promote accountability and integrity, ensure the efficiency and effectiveness of operations and processes, and reassure citizens and stakeholders that the public sector is still the institution that can be trusted to deliver essential goods and services to the public (Goodson et al., 2012, p. 14).

Efficiency is the ability to accomplish a task with a focus on maximization of time, resources, and effort. The measurement of efficiency (Chote, Emmerson, & Simpson, 2006 p. 106) is determined by the relationship between input and output. To achieve efficiency, it is desirable for organizations to produce the maximum possible output with the least input. An argument can be made that there is no defined measurement for efficiency in the public sector except to ensure that the outcome of programs produces satisfaction for the citizens. According to Bartlett (2009, p. 7), it is a poor use of public resources if government programs are fiscally efficient but do not achieve their desired outcomes of solving the problems of the citizens. The indicators and variables examined and calculated in order to determine efficiency in the public sector are fundamentally different from that of the private sector. For starters, the private sector's operations are aimed at controlling resources, making a profit, and increasing the value of the firm through investments (Mikesell, 2014, p. 2). Conversely, public organization's functions are directed at providing satisfaction for the citizens with income generated through government's coercive powers (Goodson, Mory, & Lapointe, 2012, p. 9) of taxation. The concept of public goods is not new. Adam Smith recognized the need for the provision of public goods when he postulated that the …

> duty of the sovereign or commonwealth is that of erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual or small number of individuals, and which it therefore cannot be expected that any individual or small number of individuals should erect or maintain. The performance of this duty requires, too, very different degrees of expense in the different periods of society. (1776. Bk. V, Part III, v. 1.69)

It is important that the government form and control certain programs in the interest of the public. Anomaly (2015, p. 112) describes public goods as those provided by government, which otherwise would have been difficult or impossible to attain if individuals are left to their own devices.

As more of these public organization functions are influenced by market mechanisms and private organizations move to provide more public goods, it is often debated whether the line has been blurred (Rainey et al., 1976, p. 234). The defining factor still remains that even when the private sector engages in the provision of public goods, it does so with a goal of turning a profit through contracts with the public sector. The two main characteristics of public goods are non-rivalrous and non-exclusion (Anomaly, 2015, p. 109). The producers of the goods or service cannot exclude beneficiaries and the use of said goods and services by one person does not reduce the benefits of the same good or service by another. This means that everybody in a jurisdiction receives the same services without extra cost. Mikesell (2014, p. 2) uses the example of a fire department that responds to jurisdictional emergencies for no extra cost whether it involved one or ten people, and the example of a mosquito control service provided to everyone in an area regardless of whether they live there or if they paid for the services, to illustrate the characteristics of non-rivalry and non-exclusion.

The role of the public sector in the private markets is necessary to maintain a functionally efficient private sector. Without the regulatory framework installed by government to encourage accountability and deter fraud, the marketplace will be chaotic. Governments have to use coercive powers (Goodson et al., 2012, p. 9) like taxes and fees to raise the revenue to pay for these goods and services. Through these contributions to the public coffers, the citizen becomes a stakeholder in the affairs of the state and expects competent representation characterized by integrity and accountability (Rainey et al, 1976, p. 239).

The public sector is the government's representative entrusted with the deliverance of these goods and services and safeguarding the people's assets and trust. The objective of public sector governance (Goodson et al., 2012, p. 5) is to combine processes and structure which direct, manage, and monitor activities that lead to the effective and efficient delivery of public goods and services. The public sector is the keeper of the people's trust and funds. Citizens stake their trust in their government believing that it will provide them with public goods and services when and if needed.

The Institute of Internal Auditing (IIA) is a global guidance-setting body that promulgates International Professional Practices Framework (IPPF), the standards followed by the majority of internal auditors around the world. It defines internal auditing as "an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." (IPPF, 2013, p. 1) This definition suggests that IAF is not only concerned with historical reviews but is proactively invested in ensuring that control, risk management, and governance is strategically aligned with the objectives of the organization. It not only promotes a systematic risk management approach, it is also invested in adding value to the whole organization. The demands, challenges, and opportunities that attend today's global political and economic arena accentuate the criticality of robust risk management, effective internal controls, and overall good corporate governance (Aikins, 2012. p. 196). Through the provision of assurance to management that risks and opportunities are evaluated appropriately, IAF helps to instill confidence in public organizations (Goodson et al., 2012, p. 5). An exposition of the crucial contributions of these professionals through discussions, analysis, and measurements is therefore warranted through a study like this. These contributions, however, do not preclude a review of the theoretical disputes that has attended IAF. Some of the disputes surrounding IAF that will be discussed in this paper include the reasons for the current pervasiveness of audits and the lack of criteria for measuring the success or failure of the profession. Power (1994b, p. 6), observed that a combination of lack of trust and the public's perception of audit as an influential model of administrative control may help explain the demand for more of IAF's services. This study will attempt to proffer a balanced view of IAF, discuss why it has increasingly become management's partner in the achievement of organizational goals, and encourage a compromise between its criticism and contributions.

Problem Statement

This study intends to review the impact of IAF on efficiency of programs and processes within public organizations. The aim is to use quantitative data to determine if controls recommended by internal audits have positively impacted the attainment of organizational objectives. These impacts will in turn validate whether or not internal audits contribute to the efficiency and effectiveness of programs and processes within public organizations. To the extent possible, the literature review will be used to showcase the salience, visibility, and influence the profession has had on the attainment of organizational objectives.

In light of the salience of IAF and in fulfillment of IIA Standard 1300 (IPPF, 2013, p. 22) which require the Chief Audit Executive (CAE) to develop programs that assess the efficiency and efficiency of IAF and identify opportunities for improvement, the aim of this study is to advance the research on the relevant metrics needed to accomplish this objective. Researchers have used different indicators and methods to measure the value of IAF to organizations. According to Chen and Lin (2011, p. 19) the methods range from assessment, through customer surveys from audited departments, recommendations accepted and implemented, the number of management requests for internal assurance or consulting project, and reliance by the external auditors on IAF's work. A survey conducted by the IIA's Common Body of Knowledge (CBOK) (2006, p. 197) concluded that 51.4% of respondent organizations measure the value of IAF by the number of recommendations accepted and implemented. Another survey conducted in 2010 (CBOK, 2014, p. 42) showed that the top three (3) methods adopted by IAF to evaluate performance has shifted to the percentage of audit plan completed, surveys/feedback from the board, audit committees and senior management, and the customer/auditee surveys. The survey theorized that although neither of the results from the three (3) methodologies offered the best assessment of IAF, they were commonly used because their criteria were rather easy to measure. This ease of measurement helps explain the shift in assessment methods that occurred between the two surveys.

A shortcoming of using the percentage of audit plan completed as a measurement for efficiency is that the method does not allow for flexibility to adapt to changing risks and opportunities. Surveys of boards and senior management seem to be too broad, especially since the questions are often open-ended and information solicited does not clearly illustrate the value of IAF in public organizations. This study's measurement of recommendations made by IAF and accepted by management does not in any way minimize other factors that influence efficiency in public organizations.

This study will utilize secondary data obtained from the Association of Local Government Auditors (ALGA), an organization committed to enhancing public sector auditing through education, advocacy, and training. Its membership is composed of auditors from cities, counties, school districts, water districts, tribal organizations, and other local government entities around the world (ALGA, n.d.). This study is especially important because it provides the opportunity to utilize the data collected by ALGA to shed light on both the concept and theory of IAF's contribution in the public sector.

The data was gathered as part of a benchmarking and best practices survey for participant auditors (ALGA, 2013, p. 12). This data includes information that ALGA elicited from survey respondents on organizational structure, activities, resources, fraud audits and investigation and the financial impact of audit recommendations from various types of assurance and consulting activities conducted by IAF. The Data Source section of Chapter 3 will discuss ALGA's collection technique and analyze the sufficiency of the data.

The hypotheses for the study are as follows:

H_1:

> IAF has a positive impact on the efficiency and effectiveness of organizational activities and the reduction of fraudulent activities through the financial and operational savings attributable to IAF recommendations.

H_0: (Null Hypothesis):

> IAF has no impact on the efficiency and effectiveness of organizational activities and the reduction of fraudulent activities through the financial and operational savings attributable to IAF recommendations.

H_2:

Increase in IAF funding will result in more efficiency of processes and operations within public organizations.

H_0 (Null Hypothesis):

An increase in IAF funding will have no effect on the efficiency of public organizations.

H_3:

The more funds organizations invest in IAF, the more likely they are to prevent and/or detect fraud.

H_0: (Null Hypothesis):

The amount of funds invested in IAF does not affect the detection and reporting of fraud in organizations.

For Hypothesis 1, a regression analysis will determine if there is a correlation between the recommendations for improvement made by IAF and projected dollar savings, and efficiency in programs and processes within the public sector. The dependent variable is Total Projected Dollar Savings (TPDS), while the Number of Recommendations Made (NRM) and the Number of Recommendations Accepted (NRA) are the independent variables.

For Hypothesis 2, a regression analysis will determine if there is a correlation between the funding for IAF and projected dollar savings in an attempt to show how additional funding can contribute to efficiency in the public sector. The dependent variable is Total Projected Dollar Savings (TPDS), while the Audit Department Funding (ADF) is the independent variable.

For Hypothesis 3, a regression analysis will determine if there is a correlation between the funds expended on IAF and the number of fraud audits and investigations completed during the survey time period. This measurement will assume that prevention and detection is attributable to the number of fraud audits and investigations completed during a given period. Fraud audits serve as both a prevention and detection tool through its search for inadequacies in management controls. Management also engage IAF in a consulting capacity to investigate fraud. The dependent variable is Number of Fraud Audits Completed (NFAC), and the independent variable is the Total Audit Department Funding (TADF).

While understanding that correlation is not causation, the information gleaned from the quantitative analysis is important to support the discussion of the critical roles IAF plays in enhancing efficiency within public organizations. Because of the nature of goods delivered by the public sector, efficiency measurement is not dependent on profit margins (Goodwin, 2004, p. 641) but by resource management and the effect it has on the lives of citizens. Savings and revenue enhancements constitute a significant portion of the efficiency measurement in the public sector.

This data collection, research design, hypothesis and data analysis will be discussed further in Chapter 3 in conjunction with statistical modelling, data definition, and data relationships.

Purpose of Study

The purpose of this study is to examine the value internal auditors deliver to management. This will be accomplished through an analysis of IAF's contribution to efficiency optimization within organizations. The analysis will be supported by a quantification of the financial effects of IAF activities within public organizations. This approach will be used to argue for or against how much, if any, IAF has contributed to the efficiency of programs and processes in the public sector. The general public (Adams et al., 2012; Mautz, 1966, p. 153) has traditionally associated the audit function with simply ensuring compliance and accuracy of financial statements. While this function falls under the audit umbrella (Protiviti, 2003, p. 8), it is mainly conducted by external auditors. External auditors, according to Moeller and Brinks, (2009, p. 3); Trenerry (1999); and Adams et al. (2012, pp. 9-12) are contracted by an organization to review its financial statements to ensure that they are presented fairly, that the results of operations for a given period are accurate, and that they do not contain material misstatements that may influence the decisions of financial statement users. In contrast, both Adams et al. (2012, p. 9) and IIA (March, 2015) describe IAF as an integral part of an organization with responsibilities to assist management identify risk and opportunities, evaluate controls, and add value to the entire organization.

Mautz, (1966, p. 153) posited that the internal audit and its effect on the overall health of an organization can sometimes be lost or ignored because the general public has often lumped the discipline together with external auditing, accounting, ethics, law, or finance. Also with the public's appetite for good governance, it is easy for an organizational risk approach to be muddled with legal and compliance issues (Chambers, 2012). The general public (Pickett, 2005. p. 121; Chambers, 2012; and Moeller & Brinks, 2009, p. 7) often confuse the duties and roles of external auditors and ethics officers with those of internal auditors. This confusion belies the contributions IAF makes in providing good governance in the maze of organizational functions. This study will attempt to untangle the web, and hopefully, shed some light on the true goals and purposes of the profession.

In this current environment of greater fiscal accountability and competition for scarce resources (Aikins, 2012, p. 196), it is not uncommon for the public to demand accountability. Auditors, according to Goodson et al. (2012, p. 14) are an essential element in accountability which in turn lead to strong governance in the public sector. They provide an independent assessment of stewardship of public resources (Lapointe, 2008). One of the better ways to demonstrate the value of IAF (Soh & Martinov-Bennie, 2011, p. 608) is to measure the organizational cost savings and revenue enhancements attributable to IAF. With political and public demands (Bouvard et al., 2011), alongside tightening resources, the public sector has been called upon to do more with less. The public servant is answerable to all citizens and the objective is the delivery of public goods and services with little or no consideration for profit or loss. Cels, De Jong, and Nauta (2007, pp. 6-11) postulated that making changes which may improve service delivery in a bureaucratic environment is viewed as destructive, hard to account for, non-rewarding, and at odds with both bureaucratic structure and culture. While the private sector can try and fail a thousand times in their bid to create or innovate service delivery or the manufacture of new goods with a goal of turning a profit, public organizations tend to be more methodical and less adventurous in spending public funds because of the transparency and scrutiny that attends the organization (Rainey et al., 1976, p. 239). Although the formal structure of accountability and control inherent in the public sector may not always be suitable for entrepreneurship, risk taking, and imagination, IAF has stood in the gap to assist management improve performance while still holding that fiscal line. Most public sector successes are not measured in dollars and cents but by the citizens' continued satisfaction and confidence in their government (Goodwin, 2004, p. 641), making it rather hard to provide empirical evidence of truth or falsity of the claim that government resources are utilized efficiently and effectively. Until the popularity and prevalence of quantification methods, i.e., performance measurement, balanced scorecard, social return on investment and so forth, a priori knowledge has been brought in to serve as the primary determinant of success for most government initiatives. Like most government processes, IAF (Aikins, 2012, p. 197) may have fallen into the routine of performing daily activities and ignoring measuring its impact on the achievement of organizational goals.

Because there has been limited measurement of the relationship between IAF activities (Aikins, 2012, p. 198) and their impact on the achievement of organizational objectives (Soh & Martinov-Bennie, 2011, p. 608), it is relatively easy to condemn the profession's work as an oversight function (Goodson et al., 2012, p. 5) that only reviews processes after the fact to determine whether organizations are doing what they are supposed to do. With that perception, the profession receives attention only when management controls fail or when non-compliance of rules and regulation expose organizations to fines, lawsuits, and public ridicule (Pickett, 2010, p. 369). The challenge here is how to determine if IAF is actually achieving its objectives and to ensure that resources are allocated accordingly, especially in these times when public sector activities are trending towards a result-based paradigm. In other words, what calculable results do public agencies expect to receive from their investment in IAF? The global phenomenon for accountability has resulted in the measurement and evaluation of all processes in the public sector and IAF is no exception.

There is no better time to demonstrate the Return on Investment (ROI) of IAF to the public organization. IAF activities include audits and investigations that enable public organization to save cost, enhance revenue, deter fraud, and reduce/avoid fines. Its ROI (Hudak & Wallack, 2015, p. 8) is calculated from questioned costs, recommendations for better use of funds, and other administrative savings. The inherent challenge to calculating ROI is the inability to quantify intangible contributions that accrue to organizations as a result of the work conducted by IAF. The functions of public organizations are directed at providing satisfaction, with low priority to profitability and cost factors, so a true appreciation of both the social and financial efficiency contributions of IAF to the public sector will be helpful to understand its achievements. Monetary value cannot be assigned to the social impact of some IAF contributions such as fraud deterrence and/or compliance to laws and rules, due to the presence of IAF in an organization.

Theory

To develop an understanding of IAF and its expanding (Soh & Martinov-Bennie, 2011, p. 606) role in the public sector, it is very important to consider the auditing profession as a whole and IAF in particular. Auditing and the work of IAF can play an indispensable role for both the citizenry and administrators if public organizations are to operate within the framework of budgets, rules, requirements and objectives. IAF's activities can help to ensure accountability and that public funds are used for the effective functioning of government.

The Agency Theory will serve as the philosophical orientation of this study because it informs the framework for understanding the relationship between factors that affect efficiency in the public sector. To ensure efficiency, an organization must be able to monitor its programs and processes and also ensure that there is an alignment of interests between the principals and agents. Both factors constitute the focus of agency theory. The theory describes the relationships between the principal and agent and is important in depicting the relevance of IAF in the public sector. An agency relationship arises when the owner of the resources referred to as the principal delegate decision making powers to an agent to use and control those resources (Adams, 1994, p. 8; Eisenhardt, 1989, p. 58). The theory assumes that both parties will be motivated by self-interest and that the agent, in the course of duty, will become more knowledgeable about the process than the principal (Eisenhardt, 1989, p. 63). It is only logical that a development of an oversight mechanism will help resolve the concerns that arise from information asymmetry and behaviors that benefit self-interest.

Factors like the principal/agent relationship (Goodson et al., 2012 p. 13), that exist between public administrators acting as agents, and citizens acting as the principal which requires accountability for public resources, has given rise to IAF. Aikins (2012, p. 199) postulates that the principal/agent relationship assumes that both parties will utilize their positions to maximize their wealth if given the opportunity. Aikins goes further to theorize that the agent will have custody of resources and access to more information since he is tasked with representation. Given the misalignment, the principal therefore will want to be reasonably assured that the agent is using the resources and information for the principal's best interest, hence the need for a monitoring mechanism. IAF provides the accountability that attempts to resolve the difficulty of the principal/agent relationship.

This study takes the position that systematic empirical investigation will help demonstrate the effect of IAF exerts on efficiency in the relationship between the principal and agent. Although many researchers have argued against the use of quantification and statistics (Shore & Wright, February, 2015a, p. 24), as a barometer for efficiency in public sector, other scholars (Adams et al., 2012, p. 13) counter that this view is myopic and does not take into account IAF's deeper dive into the broader context of efficiency and effectiveness. Shore and Wright (2015a, p. 24) suggested that society's preoccupation with numbers, indicators, algorithms and audits has rendered their results unquestionable and may in turn have produced a negative effect because of the overreliance on them for decision making. Shore and Wright (2015b, p. 425) also posited that although auditing and other performance measurement are not new concepts, today's overdependence on them may sometimes have a negative effect. The resultant effect of this overreliance is that organizations may get overly occupied with audit results, to the point where all operations and values are changed to only those that can be measured.

The agency theory is also relevant when the knowledge distance between the public and the bureaucrat is put in perspective. Because public sector operations are remote and physically removed from the citizens, oversight by auditors allows the citizen on the outside (Shore & Wright, February, 2015, p. 23) access to how public resources are utilized.

In order to support good governance, public sector auditors have to play a central role in fostering trust that the information asymmetry between the principal and agent is not abused or misused. Goodson et al. (2012, p. 9) posits that good governance includes setting directions through the establishment of policies to guide an organization; articulating clear ethical values, objectives, and strategies; implementing internal control; creating oversight, and maintaining a vision. As part of the effort to restore and foster the trust, it is of vital importance that IAF shows how much it has impacted the efficiency of public sector programs. According to Maali, (2013, p. 16), the most compelling measurement is the financial impact achieved by implementing audit recommendations. Soh and Martinov-Bennie (2011, p. 608) also theorized that a quantification of cost savings and revenue enhancement attributable to recommendations is important in order to denote the value and relevance of IAF in the public sector. Moreover, measuring the financial impact of IAF's recommendations is important in determining if they are meeting their oversight objectives and adding value to an organization and improving organizational operations.

Agency theory emphasizes separation of ownership and control, and the audit profession has emerged as the medium to resolve the inherent mistrust between the parties. IAF has come to be regarded as the independent validator of failure or success of processes and projects in the public sector. IAF has continually evolved from just being a watchdog with a tunnel focus on compliance (Goodson et al., 2012, p. 14) to skilled management partners who bring expertise to the improvement of management and control systems. IAF has grown from just monitoring controls of inputs to evaluating outputs and outcomes (Waring & Morgan, 2007, p. 323). Most employees in an organization have a negative connotation of IAF, believing that auditors only come around to dig up dirt or to stir up trouble (Chambers, 2012; IIA, Singapore, 2014, p. 11-

12). This could not be further from the truth (Ramamoorti, 2003, pp. 4-8) because internal auditors perform a variety of functions within the organization. The IIA, South Africa website (n.d.) asserts IAF is the unit that challenges current organizational practices through an evaluation of risk and controls; champions best practices through an analysis of organizational operations, and adds value through their partnership with management in the identification of opportunities. This study hopes to influence the salience of IAF and bring public administrators to the realization that that the end result of an audit or consulting engagement can mean something tangible to the entire organization.

The importance of the internal audit function in today's business cannot be over-emphasized (IIA CBOK, 2006, p. 25). Assisting the public sector in controlling risks and uncertainties, and taking advantage of opportunities to achieve the organization's goals and objectives, is a value-adding role of IAF (Ramamoorti, 2013, p. 14). With the amplification of globalization and its effect on both public and private industries, the role of IAF (Williams, 2002, p. 6) is vital to ensure good decision making, accountability, and better management of organizational risks.

In order to achieve a state of efficiency in the principal/agent relationship, (Adams, 1994, p. 8) which ensures that neither party can enhance their wealth at the expense of the other, the traditional internal audit staff requires transformation from being a "detective" who relies on historical financial data to a knowledge-driven, business focused, and technologically aware risk assurance manager who can design effective controls that will prevent the occurrence of unwanted events and mitigate risk in the case of an incident or accident. The paradigm has shifted from the historical backward-looking approach (Kagermann et al., 2008, pp. 4-5) in which audits only identified exceptions in organizational activities that may have been overtaken by events, to a more proactive approach where auditors identify and understand the future trends (Pickett, 2005, p. 53) while working with management to prepare for it.

For a full appreciation of IAF's contributions to the efficiency of organizations and how much it impacts the attainment of objectives, it is necessary to discuss some published information on the both IAF and efficiency. The next chapter will inform the consumer of this study about the history of the profession, its distinction from other professions that have erroneously been confused with it, factors that have influenced its salience, and the quantitative contributions of IAF. Using logical and empirical information, it will move the needle in the knowledge of how IAF helps the public administrator gain and maintain the trust and confidence of the citizen while working with management optimize efficiency in the organization.

Chapter II

LITERATURE REVIEW

This chapter will review and analyze selected research critical to the understanding of IAF's position, role, and responsibility in an organization, management's expectation of IAF, and how it all affects the efficiency of programs and processes within the public organization. It will apply a scholarly interpretation to the subject of efficiency in the public sector and how internal audits contribute to its achievement. Also, it will try to connect the relationship of citizen's trust in the public sector to the work performed by internal auditors.

IAF's scope has expanded tremendously since its inception (Ramamoorti, 2003, p. 10; Teck-Heang & Ali, 2008, p. 10; Hickman, 2012). Acting as an independent assurer that controls exist and are working as they should (IIA Singapore, 2014, pp. 3-21), IAF's focus spans a variety of organizational functions including internal controls, governance structure, operational efficiency and effectiveness, and fraud risk management (Pickett, 2005, pp. 3-6). From this position, it apparent that audit organizations remain in constant contact with and engage management to understand the overall objective and be able to identify risks, challenges, and opportunities.

The current emphasis on increasing public sector productivity, performance, and accountability (Bartlett, 2009, p. 13) lends itself to innovative, cutting edge skills of turning policy into practice with minimal fiscal input. Public sector bureaucrats are expected to do more with less (Bouvard et al., 2011, p. 1) and IAF, like other organizational units, is expected demonstrate its value to the organizations (Soh & Martinov-Bennie, 2011, p. 608) not only by the way it runs its operations (PWC, 2014) but also by capturing and reporting its contributions to the organization. As business topography grows more complex (Ramamoorti, 2003, p. 9), the risk involved in conducting business has become more complicated, requiring IAF to provide the expertise that helps organizations manage these risks effectively (Chambers & McDonalds, 2013, p. 3). PWC's State of the Internal Audit Professions (2014, p. 1) study concluded that IAF is now challenged to help organizations protect itself from risks ranging from globalization to cybercrime. Surveys conducted to support the study showed that more than 70% of board members want IAF to get involved in technology, security, reputational, and big data and business analytics risks. A historical exposition will enhance the comprehension of the evolution of the profession into a proactive management partner. To understand how IAF can influence an organization, it is necessary to discuss the history, roles, the distinction between audit typologies, and audit methodology.

History and Evolution of Internal Audit Function

> The origin of auditing goes back to times scarcely less remote than that of accounting. Whenever the advance of civilization brought about the necessity of one man being entrusted to some extent with the property of another, the advisability of some kind of check upon the fidelity of the former would become apparent. (Brown, 1905, p. 74)

The history of IAF can be traced back to whenever civilization afforded man the opportunity to own enough things to entrust some of them to the care of another man

(Goodson et al., 2012, p. 13). Semblance of formal record keeping and the attendant audit can be traced to the early organizations of business and government in the Near East, Greece, and the city–states of Italy (Teck-Heang & Ali, 2008, p. 2). According to Ramamoorti, (2003, p. 3) the concern that corrupt officials may be inclined to compromise the finances of the state or that errors and inaccuracies may occur as a result of incompetence led to the creation of oversight through a system of check and balances. The checks applied to ensure the safety of property in another person's hands can be paralleled to internal controls designed and implemented in today's organizations. Although it was not as systematic and structured, the objective was the same: an independent verification in order to reduce fraud and abuse of assets.

The advent of the industrial revolution ushered in a more structured auditing process through the passage by the United Kingdom (UK) parliament of the Joint Stock Companies Act of 1844 (Watts & Zimmerman, 1983, p. 626). This Act formalized the position and duties of auditors in organizations and granted them the authority to inspect their books of account and the books of registry (Teck-Heang & Ali, 2008, p. 3). As businesses were organized and grew in size and scope the necessity for verification of accounting information needed for business decisions became more imperative. Management also needed the means to review and evaluate the efficiency of processes in order to determine if they are in line with organizational objectives. This void was filled by the internal audit function, which brought a systematic method to accomplish the task. Growth also introduced complexity into businesses, which in turn created opportunities for fraud and misuse of assets, and management required means to evaluate not only accounting information but also the honesty of employees (Ramamoorti, 2003, p. 3).

IAF's capability to understand and respond to organizational changes (Chambers & McDonald, 2013, p. 4) coupled with the analytical abilities of individual internal auditors qualifies it to assume the responsibility of collecting and interpreting information within the organization to ensure effective and efficient operations.

The establishment, growth, and evolution of the contemporary internal auditing profession is closely intertwined with the history of the Institute of Internal Auditors (IIA). Inaugurated in New York in 1941, (Ramamoorti, 2003, p. 2) the IIA has developed into the primary international professional body dedicated to the development of the practice of internal auditing. According to Kim et al. (2012, p. 4), the membership has since grown to over 175,000 with branches in 190 countries.

Arguably, the two main contributors to the rise of internal auditing as a profession in the United States are Lawrence Sawyer and Victor Z. Brink. In addition to being one of the founding members of the IIA, Victor Brink played a key role in the issuance of the first Statement of Responsibilities of the Internal Auditor published in 1947 (Ramamoorti, 2003, p. 5). These statements expanded the duties of the internal auditor from a narrow focus on financial and accounting to include evaluation of organizational operations. His contributions include research, consulting and publishing some of the most influential books and articles on internal auditing.

Widely regarded as the godfather of modern internal auditing (Pickett, 2005, p. 3), Dr. Lawrence B. Sawyer authored *The Practice of Modern Internal Auditor* which is considered the most authoritative book in the discipline. Renamed *Sawyer's Internal Auditing* it has become the commonly referenced book amongst practicing internal auditors. His vision and articulation of the profession is chronicled in the awards that are named for him. He advanced some of the major attributes of internal auditing such as independence, professional proficiency, the scope of work, the performance of the audit and management of the internal audit department (Cohen & Sayag, 2010, p. 296).

The influence and recognition of IAF has been remarkable considering that it is a very young profession. The tremendous growth of the profession and management's desire to have IAF involved in different facets of the organization (Moeller & Brinks, (2009, p. 8) has spawned auditors with diverse backgrounds, including a large proportion who did not major in accounting. Auditors get the chance to specialize in specific areas and industries. It is not uncommon therefore to see internal auditors with specialties in oil and gas, healthcare, information technology, government, and non-profit organizations (Chambers, 2012).

Through the years, auditing standards have been designed to assist practitioners with understanding and the ability to discern the concepts essential in executing their responsibilities. The U.S. Government Accountability Office (GAO) and the IIA are recognized nationally and internationally as leaders in promoting high quality audit work through the issuance of professional auditing standards (Kim et al., 2012, p. 3). The Government Audit Standards (GAS) is promulgated by the GAO while the IPPF is issued by the IIA. The International Organization of Supreme Audit Organization (INTOSAI) also publish standards that are used by most countries outside of the United States (Blegvad, 2007). Although these standards are not mandatory, they serve as 'best practices' to provide guidance for internal auditors in the course of their work.

The GAO was established by the Accounting and Budgeting Act of 1921 (Kim et al., 2012, p. 3) which transferred auditing, accounting, and claims function and responsibilities from the Treasury Department to the new agency. Situated in the legislative branch of the U.S. government, it is independent of the executive arm with functional and administrative reporting to Congress. In 1972, working with the Government Auditing Standards Task Force, GAO issued the first edition of the *Standards for Audit of Governmental, Program, Activities and Functions* (GAO, n.d., Chapter 6). Nicknamed the Yellow Book for its bright yellow cover, it was later renamed the *Government Auditing Standard* (GAS) and has become the most recognized guideline for conducting public sector audits (Kearney, Fernandez, Green & Zavada, 2013, p. 8). It has been updated six times since it was first published, most recently in 2011.

The IIA issued its first standards for the professional practice of internal auditing in 1978. In 1998, the Institute's Governing Board appointed the guidance task force to review the continued applicability and relevance of the standards. As a result, the task force recommended a new definition of internal auditing, the IPPF, new attribute and performance standards for internal auditing, and implementation standards for assurance and consulting services (Kim et al., 2012, p. 4). Amongst the many important contributions initialed by auditing standards were the very essential concepts of independence and objectivity (Adams et al., 2012, p. 15). It separated the auditing function from management and afforded it the platform to review activities, test transactions, and evaluate controls without interference from those charged with governance.

The two most recognized and utilized audit standards are the GAS and the IPPF. Although there are many similarities and both provide a framework to promote quality audit work that is systematic, objective, and based on evidence, public sector auditors mostly adhere by GAS because it addresses government and other public sector issues directly. This is not to say that the IPPF does not address governmental issues, but the general nature of the standards could make for misinterpretation in matters that directly affect public goods and services (Kim et al., 2012, p. 6).

Standards provide a guide for auditors to conduct audits in a systematic, objective way. They also provide guidance on the attributes IAF should possess in order to deliver high quality effective audits and provide reasonable assurance that risks are addressed and efforts are made to mitigate them (Mautz, 1958, p. 17). They guide auditors on the foundation of the profession, ethics, general audit standards, financial audit standards, attestation engagement standards, fieldwork standards, and reporting standards (GAS, 2011, p. 1).

Due largely to the wave of financial mismanagement and abuse of trust in both the public and private sectors (Soh & Martinov-Bennie, 2011, p. l), it became increasingly necessary for governments and professional bodies to enact legislation and promulgate pronouncements in order to mitigate the associated risks. The legislation and pronouncements served to ameliorate the confidence in public organizations and the reliance on financial statements by private investors. A discussion of some of the legislation and pronouncements will illuminate the logical progression of the profession's conspicuousness in today's organizations.

Legislative Changes and Non-Binding Pronouncements That Have Impacted the Salience of IAF

Repeated occurrences of financial improprieties in both private and public organizations demanded the establishment of tools to strengthen internal control structures, enhance effective governance, and improve regulatory environment (Pickett, 2012, p. 21). The fallouts following these corporate scandals have prompted the search for workable and lasting solutions. Legislative changes include laws and regulations enacted by Congress that govern financial reporting and corporate governance in organizations. Non-binding pronouncements, on the other hand, are guidance developed by professional associations to help organizations achieve an acceptable level of performance while conforming to relevant rules, laws, and regulations. Pickett (2012, pp. 387-390) summarizes the knowledge and proficiency that make it logical for management to work with IAF in order to effectuate these control frameworks.

Below are some of the significant legislative changes and pronouncements that have impacted the salience and expanded the roles and responsibilities of IAF in the United States and around the world.

Foreign Corrupt Practices Act (FCPA)

The Foreign Corrupt Practices Act (FCPA) prohibits offering to pay, paying, promising to pay, or authorizing the payment of money or anything of value to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business (USDOJ & USSEC, 2012) FCPA was passed in 1977 as a result of the discovery of widespread global corruption among U.S. companies. Investigations into the Watergate scandal (Koehler, 2012, p. 932; Moeller & Brinks, 2009, p. 27) led to the exposure of falsified financial records which were made to cover domestic illegal campaign contributions and bribery payments to foreign officials.

The Act heightened the need for effective internal controls. Companies and other entities that were required to comply with FCPA needed IAF to assist with evaluation of compliance and assessment of risks to ensure that the organizations identify signs and opportunities that may breed corruption. To enhance compliance with FCPA, it was also necessary to engage auditors to advise management on internal controls that prevent corruption and/or detect common corruption schemes.

<u>National Commission on Fraudulent Financial Reporting (Treadway Commission Report)</u>

With the enactment of the FCPA, the accounting and finance community felt a need to create a structure to ensure inspection, analysis, and general direction on corporate financial reporting – thus the formation of the National Commission on Fraudulent Financial Reporting headed by James Treadwell, Jr. (Moeller & Brinks, 2009, pp. 28-31). It was an independent private sector initiative (National Commission on Fraudulent Financial Reporting, 1987, p. 1) sponsored by five (5) professional associations namely: American Institute for Certified Public Accountants (AICPA), American Accounting Association (AAA), Financial Executives International (FEI), Institute of Internal Auditors (IIA), and Institute of Management Accountants (IMA). These sponsors were jointly called the Committee of Sponsoring Organizations (COSO). Their mission was to identify the causal factors of fraudulent financial reporting and provide leadership in the areas of internal control, enterprise risk management, and fraud deterrence.

Their report, commonly referred to as the Treadway Commission Report, made recommendations on the responsibilities of public companies and the independent public accountant in improving internal controls for the avoidance of fraudulent activities. Its other recommendations include ways for SEC to improve the regulatory and legal environment and the need for auditors to obtain continuous professional education that may help prevent, detect, and deter fraudulent financial reporting (National Commission on Fraudulent Financial Reporting, 1987). COSO has since grown into the flagship organization that provides guidance in internal control, fraud deterrence, financial reporting, organizational governance, and most importantly, enterprise risk management. Its "Internal Control Integrated Framework," published in 1992 (Moeller & Brinks, 2009, p. 31) and revised in 2013 redefined the way auditors approached assessment and evaluation of internal control. It has since grown to become one of the most referenced frameworks in the United States for evaluation of compliance with FCPA, and around the world to better assess, design and manage internal controls.

Cadbury Committee (Cadbury Report, UK)

The Committee on the Financial Aspects of Corporate Governance established in 1991 by the London Stock Exchange, the Financial Reporting Council of UK, and the accounting profession in the UK was created due to investors' increasing lack of confidence in the integrity of the companies listed on the Exchange (Arcot & Bruno, 2006, p. 5). The aforementioned erosion of confidence was occasioned by failure of several large corporations in the UK. The committee chaired by Sir Adrian Cadbury published its report in December 1992, which contained a Code of Best Practices aimed at helping both public and private organizations achieve the necessary high standards of corporate behavior (Arcot & Bruno, 2006, p. 5). According to Arcot and Bruno (2006, p. 1), these codes were intentionally designed to be voluntary instead of statutory in an effort to get the boards to comply with the spirit rather than the letter of their requirements.

Criteria of Control Committee (CoCo Report, Canada)

CoCo was developed in 1992 by the Canadian Institute of Chartered Accountants (CICA) (Pickett, 2005, p. 93) to help enhance organizational performance and through the promotion of internal controls, good corporate governance, and emphasis on risk management. Its internal control framework was published in 1995 and was essentially modelled after the COSO. It describes control elements as interrelated and those elements must be viewed broadly not only to respond and adapt to unexpected risks but also to identify and exploit opportunities (Babos, 2009, p. 77).

King Committee (King Report, South Africa)

Like the Cadbury Report of the UK, the King Committee adopted the 'comply or explain' approach in their design of best practices for corporate governance in South Africa. Since South Africa's constitution recognizes corporations as a juristic person (Hendricks & Wyngaard, 2010), the King Report highlights the importance of corporate citizenship. It encourages corporations to act with integrity and consider stakeholders interests when making financial, social, ethical, and environmental decisions.

Sarbanes-Oxley Act of 2002

Although the law was primarily designed to regulate the actions of public company boards, their management, and public accounting firms; several provisions have had far reaching influence in underscoring both internal and external auditors' independence in the conduct of their duties. The bill, a reaction to the rash of corporate and accounting scandals which brought down large corporation like Tyco, WorldCom and Enron (Moeller & Brinks, 2009, p. 53), was an attempt to restore investor confidence and public trust in corporations. Commonly referred to as Sarbanes-Oxley or SOx

(Bainbridge, 2007) after U.S. Senator Paul Sarbanes and Representative Michael Oxley, the sponsors of the bill in Congress, the law enacted in 1992, (Kagermann et al., 2008, p. 8) accentuated the responsibilities of public corporations' board of directors and establishes criminal penalties for violations of its provisions. It required top management to verify the accuracy of financial information (Bainbridge, 2007). It also created the Public Company Accounting Oversight Board (PCAOB) to oversee the accounting profession; mandated companies to adopt more internal controls; required companies to have audit committees; required organizational delineations to ensure auditor independence, and designed rules to ensure better corporate governance (Bainbridge, 2007; Moeller & Brinks, 2009, p. 53). IAF has played an important role in ensuring that organizations comply with SOx through their provision of centralized and objective advice on corporate governance and control environment.

Wall Street Reform and Consumer Protection Act of 2010

The U.S. Congress passed the Wall Street Reform and Consumer Protection Act of 2010 to address regulatory gaps and oversight failures in the U.S. mortgage, securities, and financial market. This was in response to the financial crisis of 2007-08 (Dodaro, 2012). Currently the most comprehensive overhaul of the financial regulatory system since the Great Depression, this act was enacted "to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes" (H.R. 4173, p. 1).

Other Factors and Current Events That Highlight the Importance of IAF

It is no secret that public organizations have undergone fundamental transformations, which have posed challenges for governing bodies relative to exercising stewardship, enhancing value, and ensuring equity while retaining confidence in the provision of public good (Goodwin, 2004, p. 641).

Several factors have contributed to management's increased reliance on IAF to provide reasonable assurance that organizational performance is in line with objectives and that public trust is maintained. The position of both internal and external auditing has been slowly moving from obscure to prominence over the years until a major acceleration occurred with the financial failures of global corporate giants such as Enron, WorldCom, Tyco International, Adelphia, and other organizations due largely to the lack of internal controls (Williams, 2002, pp. 3-6).

Technology (Gantz, 2014, p. xxi) and the expansion of the global political and economic activities (O'Brien & Williams, 2013, p. 27), have further contributed to the heightened attention and sustained prominence that IAF has received in the past few years. These factors and their connections to IAF's visibility are discussed below.

Information Technology

With the world becoming flatter (Friedman, 2005) and the dominance of technology increasing, it is imperative that oversight become an integral part of the world's financial and political systems. Increased connectivity that is needed to stay in tune with today's business environment, combined with the openness needed in information systems to promote its availability, demand a measure of regulation and a requirement to comply with laws and rules. As much as the advancement in information technology, commonly referred to as cyber, has accorded us speed and efficiency (Protiviti, Inc., 2003, p. 18), comfort, and effectiveness in our everyday lives, it has also been attended by abuse and misuse. News of information theft, computer fraud, penetrations, denial of service attacks, website defacing, and social network abuse is rampant around the globe (USGAO FISCAM, 2009, p. 34). White collar criminals have found the cover of the internet (Williams, 2002, p. 13) as a haven to conduct nefarious business, exploit financial institutions, and in the most extreme cases, enhance terrorism. Information System (IS) auditors are charged with the assessment of internal controls (Gantz, 2014, p. 5; USGAO FISCAM, 2009, p. 40) built around information assets of an organization to determine its security, integrity, reliability and availability. IT auditing is the evaluation of the physical security, financial and business control, infrastructure, policies and procedures that govern information technology within an organization with a view of ensuring data integrity and alignment with business objectives (Gantz, 2014, pp. 5-9).

Global Economy and Politics

Globalization has long been considered a major contributor to the rise and mainstay of IAF as a profession. Globalization (O'Brien & Williams, 2013, p. 27) can be defined as the social, political and economic interaction of people, businesses and government of different nation states. Globalization has increasingly integrated economies through trade and financial transaction as well as movement of people and knowledge that enhance international trade across geographical borders (Tang, 2007, p. 141).

Conducting business outside of geographical boundaries has become the norm for both public and private organizations. Every aspect of political, social, and economic activity (Williams, 2002, p. 3) has been or will be affected by the limitless opportunities spawned by the novel, unfamiliar emerging markets that has accompanied global expansion. Along with opportunities, globalization has also introduced some challenges ranging from the impact on economic growth and cultural integrity of developing nations to the threats to the environment. Arguments have been made by both proponents and opponents on the benefits and demerits of globalization (Tang, 2007, pp. 141-142) but no matter what side of the argument one finds themselves on, there is no denying that its effect can be felt on the environment, security, economy, culture, human, and physical health of societies around the world. These interactions have introduced the element of diversity and complexity in the types of risks that accompany global relationships.

Internal auditing has been adapted by both public and private organizations to ensure that effective controls are adopted and implemented in keeping with the culture, social, economic, and political differences that exist within the international markets and communities (Hickman, 2012). The profession has focused heavily on understanding not only the opportunities but also the threats posed by globalization. With the mindset that historical transactions are only important relative to the future (Kagermann et al., 2008, pp. 4-5), IAF has the ability to design risk models that identify and prepare for unrealized global risks. Management can therefore rely on input from IAF when making global decision because of the profession's proficiency in identifying risks.

Difference between Internal and External Auditing

People oftentimes confuse the two disciplines of auditing (Pickett, 2005, p. 6) and tend to lump internal and external auditing into one category; thus, a discussion of the distinction between the two is warranted. According to Adams et al. (2012), the juxtaposition of external and internal auditors are only limited to each of their abilities to review the adequacy of financial controls. Although both have a duty and responsibility to ensure that financial internal controls are working as designed albeit from different views, the differences between the two branches are greater than the similarities.

External auditors are not employed by the organization but are rather contracted (Pickett, 2005, p. 31; Moeller & Brinks, 2009, p. 3) to report on the fair presentation of the financial statements (Adams et al., 2012, p. 9) and compliance with Generally Accepted Accounting Principles (GAAP). In other words, they are hired guns whose responsibilities end with the periodic review and report on the financial statement. Internal auditors on the other hand are an integral part of an organization (Adams et al., 2012, pp. 9-12; Moeller & Brinks, 2009, p. 3) with the responsibility of providing stakeholders with the information to perform their duties. Internal auditing has been widely regarded as a profession charged only with ensuring that financial statements are reported fairly and not materially misstated. In reality, it has evolved from just ensuring compliance with financial requirements to being management's strategic partner; from being considered just corporate watchdogs to the provision of control systems that ensure adherence to corporate visions; from a necessary evil to skilled professionals who bring assurance that management is operating efficiently and effectively (Moeller & Brinks, 2009, p. 7; Pickett, 2005, pp. 110-113).

External auditors issue opinions on financial statements which help investors determine if an organization is a going concern and worthy of an investment. Their reviews, evaluations, and examinations are mostly historical in nature and present an independent opinion based on the review of only financial information (Adams et al., 2013, pp. 9-12).

According to PwC (2012, pp. 5-6), these opinions comprise the following: Clean or Unqualified, Qualified, Adverse and Disclaimer. Clean or Unqualified means that an entity's financial statements comply with GAAP, are free from material misstatements, and present a fair and accurate picture of the organization. An Unqualified opinion is given when the auditor believes that except for specific matters explained in the report, the financial statements give a true and fair view of the financial position of the organization. Qualified Opinion means that although the financial statements were not misstated, there is a scope limitation or material departure from GAAP. An Adverse Opinion is issued when the financial statements of a company are materially misstated and do not give a true and fair view of the organization's financial position. Finally, a Disclaimer of Opinion is issued when the auditor could not form, and consequently refuses to present an opinion, on the financial statements. One of the main reasons for an auditor to issue a disclaimer is non-completion of work due to factors attributable to the audited.

Kagermann et al. (2008, p. 4) espouses that IAF, on the other hand, focuses on future events with an emphasis on the risks that may affect the organization's overall health. The ability to conduct organizational risk assessments afford IAF the opportunity to look at the underlying operations that generate the numbers used to conceive the financial statements. To put it succinctly, while external auditors are concerned with the validity of numbers on financial statements, internal auditors go further to focus on the broader context of efficiency, effectiveness, and compliance of the factors that produce the numbers on the financial statements (Pickett, 2005, p. 31).

Internal auditors utilize the comprehensive knowledge gained through interactions with the different programs and processes (Gantz, 2014, p. 14) to enhance their organizational appraisal capability and offer value-added recommendations. Despite the differences, both branches benefit from each other's complimentary skills by relying on work performed by either branch when possible, in order to eliminate redundancy. Table 1 summarizes the differences between external and internal audits.

Table 1: Differences between External Audit and Internal Audit

External Audit	Internal Audit
Contracted by an organization to review its financial statements to ensure that they are presented fairly, that the results of operations for a given period are accurate, and that they do not contain material misstatements	Internal auditors are employed by the organization, making it an integral part and management's strategic partner. Reviews governance, risk management and control processes
Issues opinions on financial statements which help investors determine if an organization is a going concern and worthy of an investment	Issues reports that summarizes efficiency and effectiveness of operations
Concerned with the validity of numbers on financial statements	Goes further to focus on the broader context of efficiency, effectiveness, and compliance of the factors that produce the numbers on the financial statements.
Mostly attracts finance majors who understand financial statements	Attracts people with diverse knowledge, qualifications, and backgrounds
Reviews are historical in nature	Focus on future events with an emphasis on the emerging risks that may affect the organization's overall health

Source: Adams et al., 2012

Value of Internal Auditing in the Public Sector

Public sector audit is defined by the Canadian Comprehensive Audit Foundation as "independent, objective assessment of the fairness of management's representation on performance or the assessment of management's system and practices, against criteria, reporting to a governing body or others with similar responsibilities" (Graham, 2014, Chapter 11). According to GAS (2011, p. 11) "government auditing is essential in providing accountability to legislators, oversight bodies, those charged with governance, and the public. Audits provide an independent, objective, nonpartisan assessment of the stewardship, performance, or cost of government policies, programs, or operations, depending upon the type and scope of the audit."

It is the responsibility of the public sector to manage resources and activities to ensure that goods and services are provided to the citizens equitably. Through the use of assurance and advisory services, IAF provides unbiased, objective assessments of whether public resources are managed responsibly and effectively to achieve intended results.

Trust in government has been on the steady decline in recent years. Trust is a powerful tool for increasing efficiency, cutting costs, and increasing accountability. As defined by Chami and Fullenkamp (2002, p. 6), trust is "a confident reliance on the integrity, veracity, or justice of another." While the citizens generally agree on the services that their government should provide, the accountability which fosters trust to deliver those services is always in question. In order to support good governance, public sector auditors have to play a central role in fostering trust. Goodson et al. (2012, p. 9) posits that good governance includes setting directions through the establishment of policies to guide an organization; articulating clear ethical values, objectives, and strategies; implementing internal control; creating oversight; and maintaining a vision. It should align policies and procedures with public sector ethics and values that encourage integrity in employees and officials.

The special responsibilities inherent in public organizations accords them different levels of scrutiny, oversight, and accountability. Geuras and Garofalo (2011, p. 5) noted that the skills, competence, and commitment of public servants are tested daily because of the complexities and complications that abound in the environment in which they work. Both policy makers and bureaucrats (Geuras & Garofalo, 2011, p. 9) are always faced with the value-laden (Denhardt, 1989, p. 187) choices and the paradoxical question of whether and how values and moral dimensions should be used to make decisions in the pursuit of public good. As stewards of the social contract between the citizens and their government, trust and accountability must be the cornerstone of service.

The scope of this study is focused on public sector auditing, thus an understanding of the composition and relationships of IAF within that sphere is requisite. According to Goodwin, (2004, p. 641), the two major differences between IAF in the public and private sectors are 1) public sector activities are mostly authorized by legislation which introduces an element of rigidity in their framework, and 2) priority to profitability and cost factors is low due to the nature of goods and services provided by the public sector. Public sector includes but is not limited to national, regional (state and provincial), and local (county, city, village) governments as well as quasi-governmental and international government organizations (Goodson et al., 2012, p. 4).

The persistent perception by citizens of the lack of transparency in their government and inefficient use of public resources has resulted in a crisis of confidence in representative democracy. Public expectation of transparency (Rainey et al., 1976, p. 239) and that their resources will be managed effectively and efficiently to support service delivery has elevated the outcomes of IAF's audit, review, evaluations, and assessment. Transparency in the public sector is required to avoid collusion that may lead to misuse or abuse of public resources. Many jurisdictions have codified transparency mandates and it has worked favorably to deter malfeasance and perpetration of fraud by public administrators and officials.

It is rather important at this juncture to discuss a nuanced view of transparency. Roberts (2009, p. 962), posited that the possibility of a complete transparency is an impossible fantasy which is both alluring and terrifying at the same time. Alluring because of the comfort it provides that resources are protected and terrifying because of the scrutiny that accompany the ideal. Organizations should therefore be wary of only managing with transparency because the attendant scrutiny can sometimes result in critical decisions being withheld or passed on in compliance with transparency requirements.

Transparency through audits, Power (1997, p. 98), can also have unintended consequences on organizations. The ever-present nature of audits and other evaluation methods condition organizations to gear their performance toward ensuring they look good for the auditors at the expense of other efficiency factors. After examining the impact of transparency in local governments, Rauh (2016, p. 292) concluded that it neither produces negative nor positive behavior. Managers act in anticipatory manner, especially when transparency threatens their budget, even if the action does not support the overall mission of the organization. One would be expected to act in a manner that maximizes utility, thus the protection of programs that contribute to measurable outcomes. Despite the limits of transparency, it is the foundation upon which confidence is built. Accountability through transparency is a deterrent to collusion and fraud in the public sector.

Public sector internal auditors, are required by GAS (2011, p. 9) to serve the public interest, which entails discharging their professional responsibilities with integrity, objectivity, and independence. These attributes are critical and essential to providing accountability to citizens and for restoring and maintaining trust between citizens and their government. Trust and confidence in government is necessary because erosion of either may have consequences that include but are not limited to opposition to government programs, apathy to the political process, and unwillingness to contribute to the welfare of the state in the form of taxes (Herrick, 1983, p. 43). IAF contributions in ensuring that citizens remain engaged and willing to participate in representative democracy can arguably be described as the raison d' ètre for public sector auditing.

The price of a betrayal of public trust can be high as public agencies are created to serve worthy causes and thus carry a moral value. They are funded by taxpayer dollars and are implicitly expected to function with integrity (Goodson et al., 2012, p. 11). Dereliction of ethics or an abuse of stewardship by a policy maker or a public administrator can lead to the withholding or eventual defunding of critical programs or activities.

To guarantee that the coercive powers (Rainey et al., 1976, p. 239) to collect taxes granted to the government by the Constitution and the subsequent stewardship of public funds accorded the public sector is not abused, it is critical that controls are in place to ensure fairness, accountability, transparency, integrity, and equity. Accountability is effected through ensuring that both policy makers and the bureaucrats that implement the policies understand their responsibilities and roles within the organizational structure (Norman-Majors, 2011, p. 244). A key element of good governance is openness and the ability to disclose information regarding performance and operation (Goodson et al., p. 11). This gives the public a view of how decisions and transactions concerning their public dollars are made. Although most public organizations are required to conduct meetings publicly and produce documents upon request, IAF serves as the conduit between the public and the government by providing reasonable assurance on operational performance and financial status of the organizations.

Public sector governance demand fairness and equity because of its unique responsibility to provide goods and services to all. Although equity and fairness may be considered normative concepts, hardly a day goes by without valid or unfounded news of partiality or discrimination by public agencies in the distribution of resources. This then invites the question: “For whom does the government operate?” The theoretical answer is that the government operates to ensure that all citizens participate equally in the consumption of social goods (Norman-Major, 2011, p. 238). In practice, economic, social, and moral factors influence the allocation of public resources, requiring an independent oversight to ensure its equity.

An effective public sector audit activity strengthens credibility and appropriate behavior amongst public officials. It enables citizens to hold public officials accountable and promotes good governance (Goodson et al., 2012, p. 10). The public sector auditor's role supports the governance responsibilities of oversight, insight, and foresight. To this end, IAF must be configured appropriately and should also be independently positioned to enable entities to fulfill their duty with transparency and accountability.

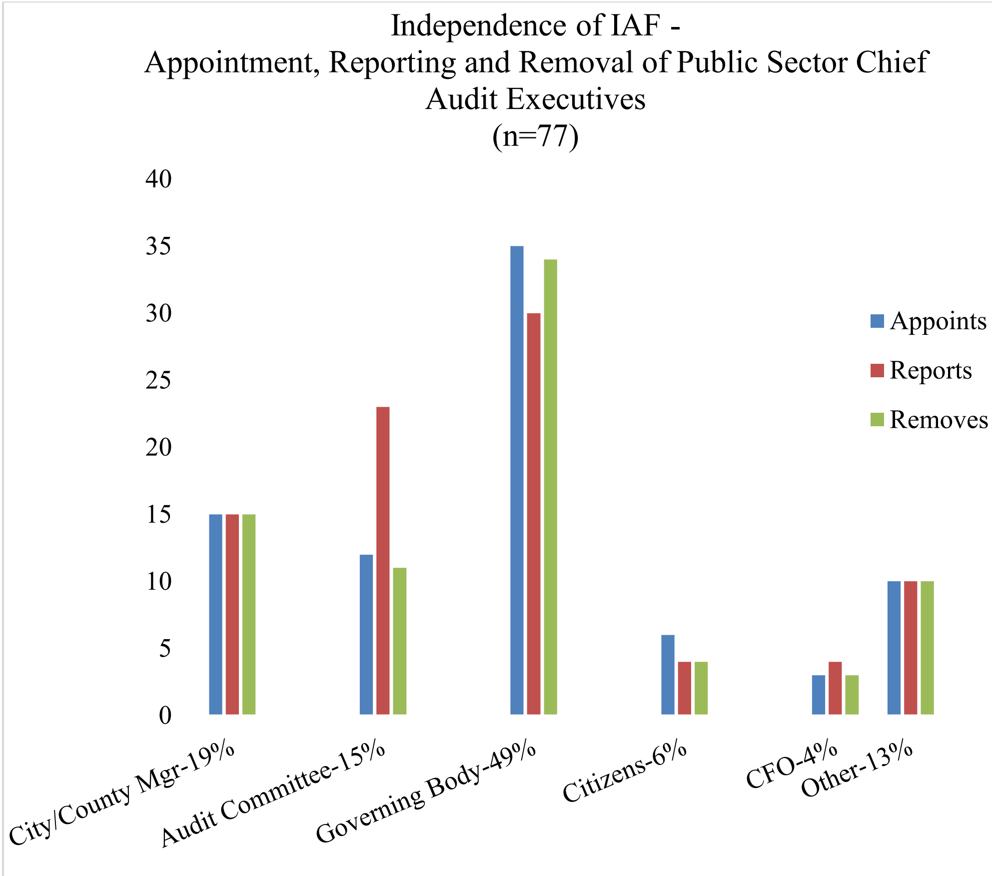
Oversight, according to Goodson et al. (2012, p. 14), addresses whether entities are doing what they are supposed to do and serve to detect and deter public sector corruption. Dodaro (2012), describes insight activities as the evaluation of programs and policies to determine their strengths and weaknesses and sharing best practices information gleaned from these evaluations horizontally across particular organizations of employment and vertically through different levels of government. By contrast, foresight activities include the utilization of a systematic approach to identify emerging risk, key trends and opportunities for the public sector to borrow from, take advantage of, or adapt to.

Monitoring the effectiveness of management's internal control structure to identify and reduce the conditions that breed corruption is a key responsibility of IAF (Dye, 2007, p. 8). Although establishment and implementation of internal controls are management's responsibility (Pickett, 2005, p. 78), IAF is charged with monitoring these controls to ensure that they are maintained and are effective to deter fraud, waste, and abuse of organizational assets (Protiviti, 2003, p. 10).

For public organizations to maximize IAF's value (Picket, 2005, p. 117; Gantz, 2014, p. 47), it must be empowered to produce reliable results by first and foremost ensuring that the activity is strategically placed where independence is not impaired. Organizational independence is required for IAF to conduct its work without interference or the perception of interference from the audited entity or its management. Organizational independence is also impacted by how a Chief Audit Executive (CAE) is appointed and terminated and the reporting structure applicable in the organization (Goodson, 2012, p. 18). The IPPF (2013, p. 49) states that “the CAE, reporting functionally to the board and administratively to the organization’s chief executive officer, facilitates organizational independence.” In other words, the CAE should be free to staff the audit activity and to audit any and all parts of the organization without undue influence or fear of retaliation from management or politicians. They should be empowered to report exceptions and other significant issues to the appropriate authorities. Data collected for this study show that the majority of CAE hiring, reporting, and dismissals in the public sector is conducted by appropriate authorities that accord them the independence to conduct both assurance and consulting functions and to support management in meeting their objectives. Of the 104 respondents to the ALGA survey, 77 (74%) responded to the question requesting information on the appointment, reporting and removal of the CAE.

The graph below show a summary of their responses. The majority of respondents indicated organizational independence with only 19% reporting functionally and administratively to management.

Graph 1: Independence of IAF



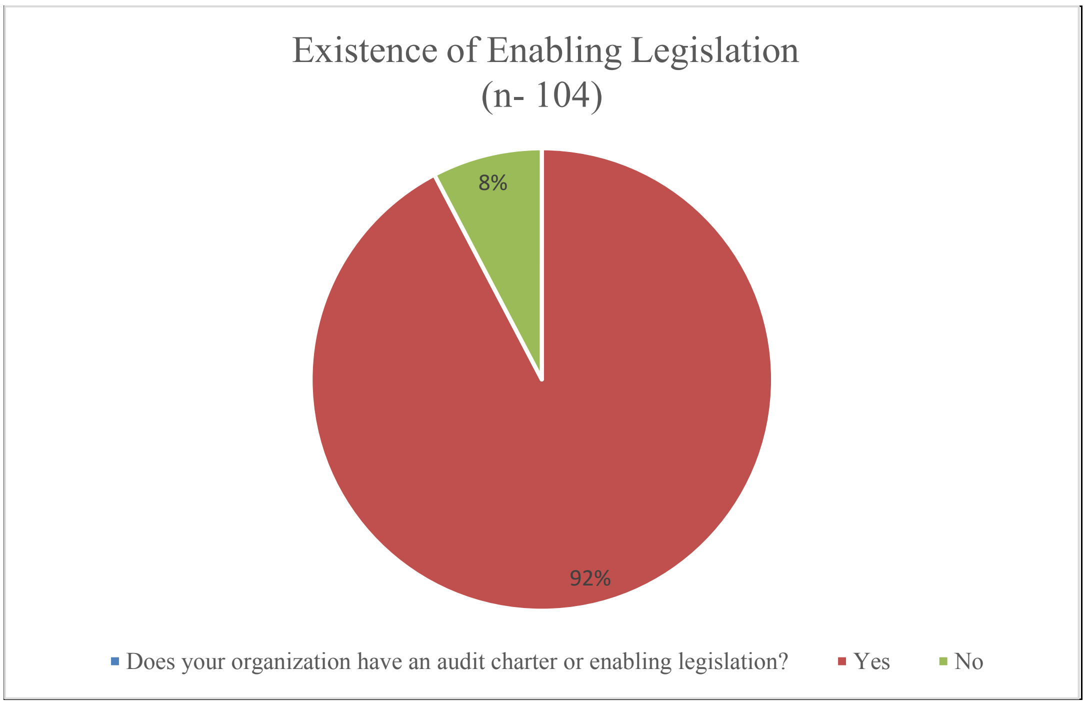
Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Another important factor that ensures the work of IAF enjoy utmost consideration by an organization is the establishment of the function's powers and duties in the public sector's constitution, charter, or other basic legal documents (Gantz, 2014, p. 50). A formal mandate for IAF signifies the organization's investment in risk assessment and mitigation. A charter or codification in statutes or ordinances (Pickett, 2010, pp. 325-332) establishes IAF's position in the organization and addresses important issues such as role, responsibilities, plan, reports, access, and independence.

The chart below show how all sampled audit organizations responded to the question about the existence of an audit charter or enabling legislation. Ninety-six (96) of 104 audit organizations expressed knowledge of a formal mandate establishing their function with eight (8) indicating no knowledge of its existence or lack thereof.

Chart 1.

Respondents that Reported Knowledge of the Existence of Enabling Legislation



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Unrestricted access to information within an organization is also necessary for an effective IAF. Enabling legislation should grant IAF complete and unrestricted access to employees, property, and records as appropriate for the performance of its activities.

Other factors needed for IAF to achieve the goal of producing reliable services include but are not limited to sufficient funding, competent and objective staff, stakeholder support, and adherence to professional audit standards (Goodson, 2012, p. 8). The table below shows the average amounts expended by public organizations on IAF for both assurance and consulting services. Some audit shops included payments made to outside consultants contracted by IAF to provide specialized knowledge of processes. Of the returned surveys, 95 supplied information on both the budget for the entire organization and funds dedicated to IAF. Table 2 shows the average budget of IAF compared to the entire organization.

Table 2: Average Funds expended on IAF by Public Organizations (n = 95)

(Funds reported in Thousands)

IAF Staffing Level	No. of Audit Shops in Category	Average IAF Budget	Average Entire Organization Budget
1-2	12	$178,548	$221,898,181
3-5	34	$583,816	$823,258,158
6-10	29	$1,029,735	$1,551,760,722
11-15	11	$1,766,591	$3,124,835,930
+16	9	$3,199,667	$4,925,557,402
Total	95		

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

The diverse political and economic landscape of public organizations over the past decade underscores the importance of attracting and retaining IAF team members who are adept at understanding and anticipating change (Soh & Martinov-Bennie, 2011, p. 17). The very important role of technology (Gantz, 2014, p. 1) and its ever-changing nature (Gauthier, 2004, p. 20) further amplifies organizational risks and ambiguity, thus making the need for diverse auditor skills not just important but critical. The possession of soft skills (Hickman, 2012) and industry specific knowledge (Moeller & Brinks, 2009,

p. 19) are also necessary contributors to success as an internal auditor. To fully understand the process being audited, an auditor must tap into their soft skills in order to manage relationships and communicate with the customers. Understanding that the auditee is the owner of the process and establishing a balance between the audit approach and soft skills can improve the chances of identifying risks and opportunities within the organization.

Theoretical Dispute: Audit and Auditability

This contemporary literature in the field of internal auditing has been squarely focused on the best way to address the criticism that public trust in internal audits as a measure of organizational efficiency is misplaced. These criticisms range from perceived pervasiveness of IAF to accusations that the discipline creates new circumstances to validate its existence. IAF has been referred to as a dull but worthy, boring, and parasitic profession which does not attract public attention until there is a perceived failure (Power, 1994b, p. 4). Although this study is focused on IAF's contribution to efficiency in public organizations, it will behoove us to first carry out a systematic and constructive inquiry into the ubiquity of the profession. Why has there been a pervasiveness of IAF in public organizations, and are activities conducted by IAF necessary for organizational survival? Is the explosion due to a necessity, an accident or a conspiracy?

At the root of these criticisms is society's suspended belief in the "idea of audit" instead of its technical practice. The word 'audit' is loosely used to refer to any formalized checking of work thus we hear medical, management and teaching audits. The phenomena that majority of the society experience these types of 'audits' makes it even difficult to assume a consciousness of audit as a profession is possible without a masterful job by the profession's image strategists. Power (1994a, p. 301), hypothesized that three factors have led to the explosion of audits. The first is that audit processes remain invisible to the public; secondly, the politics surrounding regulatory failures have intensified the requests for audits; and finally, that the profession controls the narrative in the context of its operations.

For starters, audit pervasiveness can be traced back to the agency theory. A deconstruction of the theory suggests dubiety in the relationship between the principal and agent, casting the agent as untrustworthy, whose commission needs to be overseen by an independent party. As mentioned earlier, the audit profession emerged as the medium to resolve the inherent mistrust between the parties or as the risk reduction technology (Power, 1994a, p. 301) which inhibits the 'deviant' actions of the agent. The auditor has come to be regarded as the independent validator of failure or success of processes and projects. The general public, seeking comfort from an anxious society, looks to auditors to soothe their apprehension of public administrators.

The frequent use of audit reports as a barometer for decision making has arguably granted legitimacy to IAF. This legitimacy has been derived from the perception that an audit (Maltby, 2008, p. 392) confers upon the audited entity a blessing or an admonishment of its activities. Contemporary literature suggests that the public perceives, without a verification of the auditor's competence or relevance, that an independently audited organization has earned the trust and confidence of taxpayers. This situation invites the question: "Who polices the police?" Power (1994a, p. 304) argues that because the audit has been elevated to possess an uncontestable value, it has been allowed to evade the scrutiny of its operational substance. In other words, it is more important to know that an audit is conducted than to know how the audit was performed. Auditing has been referred to as the industry of comfort production (Power, 1994b, p. 147) but the danger, however, of bestowing so much confidence in audits leads organizations to place more emphasis on the process rather than substance. A measurement criteria of the process of auditing, according to Power, will enable the public to "look beneath the surface of audit practice into the box" (Power, 1994b, p. 147).

There is truth to this position that the profession has been left up to police itself on the quality of audits produced. IAF, in its own right, has done a masterful job in crafting the image of a "quasi-scientific practice which derives its rationality from a certain instrumental neutrality in its mode of operation" (Power, 1994a, p. 308). The profession has been accused of using abstract principles to create an operational ambiguity which has endeared it to the unsuspecting public. IAF has endeavored to answer that criticism with the design and establishment of nationally and internationally recognized standards aimed at assisting practitioners to understand the attributes required and to equip them with the ability to discern concepts essential in executing their responsibilities. The creation of these standards has not had the desired calming effect but instead has been viewed by the critics as further fortification of the walls around the institution. They accuse the profession of using the standards as a means to blame individual auditors for the profession's failures, instead of the general process.

Critics have argued that politics surrounding regulatory failures have intensified the requests for more audits. Financial failures of global corporate giants such as Enron, WorldCom, Tyco International, Adelphia, and other organizations due largely to the lack of internal controls (Williams, 2002, pp. 3-6) have catapulted IAF to prominence. These failures, instead of initialing a reevaluation of auditing, have prompted calls for more audits. Critics have argued that the weight assigned to audit reports can sometimes be misleading. The argument assume that audits are infallible. The truth is that audits can fail, as exemplified in Arthur Andersen's inability to detect fraud at Enron, which led to the demise of both corporations.

The politicization of the public sector lends itself to the purification of blame with the assistance of IAF reports. These reports can easily be used to transform political problems and issues to managerial and vice versa. Blames for financial failure have also been allocated to a lapse in the audit process, which is always addressed by extensive codification of new official audit guidance (Power, 1994b, p. 23). In other words, the cure for a failure in the audit process is enactments of more compliance requirements for the auditors to evaluate. This argument conveniently dismisses the public's intellectual capacity to discern the successes and failures of audits.

IAF has also been accused of encouraging and in some cases, creating new auditable phenomena, in order to remain valid. Value-For-Money, management, quality, and environmental audits are examples of fabrications hoisted on the gullible public, as cited by Maltby (2008, p. 393). The proliferation of things to be reviewed and evaluated connotes a dark and creepy Big Brother is watching environment and smacks of a conspiracy for auditors to control processes. Buried in the accusation is the misconception that audit is appropriated to mean more today than an independent, systematic evaluation of an organization's internal controls, records, operations, and performances in order to access its validity and reliability. The social and cultural translation attached to the idea of audit is at the foundation of this criticism.

Power (1994, p. 21) argues that society's apprehension of public administration has bestowed an air of inerrability upon public sector IAF which allows it to create more tentacles to the discipline. The public image of IAF as a panacea for all organizational ailments has fostered the proliferation of audits in the public sector. The recommendation of controls, improvement in processes, revenue enhancement, and cost savings attributable to IAF are not newsworthy. It is fashionable to call out IAF when audits fail to recognize exceptions that lead to corporate failures. Nevertheless, the critics make cogent points and the criticism is well intended. This study takes the position that a quantitative approach to the contributions of IAF is germane in light of the criticism that the discipline is facing. The expectation is that it will engender further inquiries from both academics and practitioners on the real or perceived benefits of internal auditing.

The researcher interviewed five (5) Chief Audit Executives (CAEs) on what practitioners can do to stem the tide of criticism that invisibility of the audit process has granted it an air of invincibility; and that IAF creates new auditable phenomena in order to remain valid. The congruent response was that the profession has not done a good job in communicating the processes by which it arrives at conclusions of exceptions in public administration. The dearth of information on the evaluation, review, and examination methodology of IAF has further mythicized the profession. A window into the fieldwork practice will not only allow the public to scrutinize its operational substance but will go a long way in lifting the veil of secrecy that has surrounded the profession.

<u>IAF's Impact on Efficiency in the Public Sector</u>

In order to appreciate IAF's impact on efficiency in the public sector, one has to understand the activities that are performed. The measurement of efficiency in the public sector is determined by the relationship between the input, throughput, output, and outcomes (Stroobants & Bouckaert, 2012, p. 247; Waring & Morgan, 2007, p. 327). To achieve efficiency, it is desirable for organizations to produce the maximum possible output with the least input. Efficiency is the optimal use of resources to produce intended results. It is intrinsically linked to effectiveness because of the relationship between optimal input and intended purpose (Norman-Majors, 2011, p. 235).

The definition of efficiency in the public sector may be somewhat contested because it consists not only of the measurement of quantitative and/or statistical data but also the achievement of desired outcomes. The delivery of efficient public service that does not satisfy the consumer citizen is considered poor use of public resources (Bartlett, 2009, p. 7). Management thus designs internal controls to ensure that goals and objectives are attained with the least expenditure of scarce resources.

In contrast to efficiency measurement in the private sector that only takes the bottom line into account (Stroobants & Bouckaert, 2012, p. 249), the public sector accounts for efficiency through both resource utilization and improvements to citizens' lives. Gone are the days when IAF solely provided the traditional audit of internal controls in organizations. Over the years, it has evolved and graduated to delivering other value-added services that help organizations achieve their objectives (IIA CBOK, 2006, p. 56). IAF impacts efficiency in public organizations through their work on assurance and consulting. The IPPF divides internal audit activities into two major categories: assurance and consulting services. It defines assurance (IPPF, 2013, p. 11) as services "that involve the internal auditor's objective assessment of evidence to provide opinions or conclusions regarding an entity, operation, function, process, system, or other subject matter." It further defines consulting services as "advisory in nature and generally performed at the specific request of an engagement client with its nature and scope subject to agreement with the engagement client." Consulting services generally involve the person or group offering the advice which in this case is the internal auditor, and the engagement client seeking and receiving the advice.

The services provided as assurance services by IPPF are referred to by GAS as audit and attestation, while consulting is referred to as non-audit services (Kim et al., 2012, p. 9). Audits and attestation services comprise but are not limited to financial and performance audits and attestation engagements, while non-audit services may include business process improvement, continuous monitoring, control self-assessment, and ethics trainings. For the purpose of this study's clarity and consistence, assurance and consulting services will be used to refer to audit activities.

A discussion of the categories of services provided by internal auditors is worth exploring in order to get an understanding of how IAF supports efficiency and add value to an organization.

Assurance Services

As mentioned earlier, assurance services are composed of financial audits, performance audits, and attestation engagements. Financial audits, according to Kagermann (2008, p. 126) are those performed to ensure that financial statements and accompanying disclosures are presented accurately, fairly, and free of material misstatements. It serves to validate and add credibility to the financial position of an organization (PWC, 2012, p. 3). It uses risk assessment, internal control testing, and other substantive procedures to provide an analysis of the economic activity of the organization and to report that information through an accounting viewpoint. PWC (2012, p. 3) argues that financial audits provide reasonable assurance of the financial stability of the organization. Financial audits are mostly conducted by external auditors with assistance from internal auditors (Moeller & Brinks, 2009, p. 700) who, as employees of the audited organization, can bring superior knowledge of operations and processes to the engagement. Furthermore, with a host of financial regulations to comply with, IAF is most suitable to stand in the gap between organizations and external auditors.

GAS (2011, p. 14), defines performance audits as…audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

The objectives for performance audits vary and include assessment of effectiveness and efficiency of organizational processes, evaluation of internal control, and compliance with regulations (Goodson et al., 2012, p. 21). The most common types of performance audits mostly conducted by IAF are operational, compliance, and information technology audits. It is important to note that the fields of performance audits have commonalities that are interrelated to each other (Kagermann, 2008, p. 118). The conduct of an operational audit will entail an evaluation of compliance and a review of the information systems; likewise, the performance of a compliance audit will also involve the assessment of compliance to required rules and laws.

Internal auditors also conduct attestation engagements when they provide reasonable assurance on information that is the responsibility of another party. As the word ‘attest’ suggests, these engagements only require internal auditors to corroborate information produced by another party for the eventual use or benefit of a third party (Messier et al., 2014, p. 14). As opposed to financial audits that are conducted with a goal of expressing an opinion on the fair presentation of financial statements, an attestation engagement substantiates an assertion or set of assertion made by a third party. According to GAS (2011, p. 16), attestation engagements consist of examination, review, and agreed upon procedures of a subject matter or assertions about a subject matter that is the responsibility of another party.

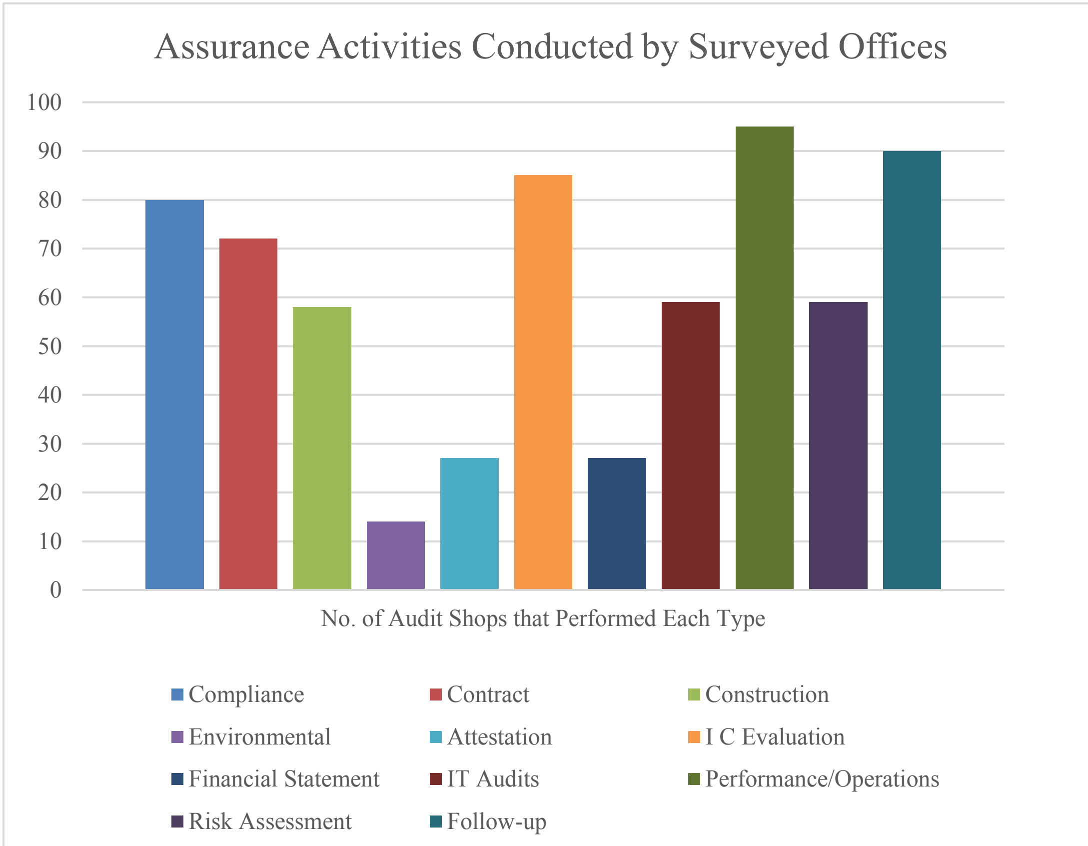
Both the table and graph on the next page show the assurance services provided by the surveyed audit organizations, categorized by type of audit, and the number of audit shops that performed each type (n = 104).

Table 3: Assurance Services Provided by Surveyed Organizations

Types of Audit	No. of Audit Shops that Performed Each Type
Compliance	80
Contract	72
Construction	58
Environmental	14
Attestation	27
Internal Control Evaluation	85
Financial Statement	27
Information Technology Audits	59
Operations	95
Risk Assessment	59
Follow-up	90

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Graph 2: Assurance Activities Conducted by Respondents



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Risk Identification and Assessment

Advances in technology and economic globalization have not only obliterated geopolitical landmarks (Pickett, 2005, p. 272), they have brought along with them an unsavory cocktail of risk that attends the way businesses are run and governments operate (Andersen, 2006, p. 7). Identifying and assessing risk has become even more difficult as public organizations venture into the global market square.

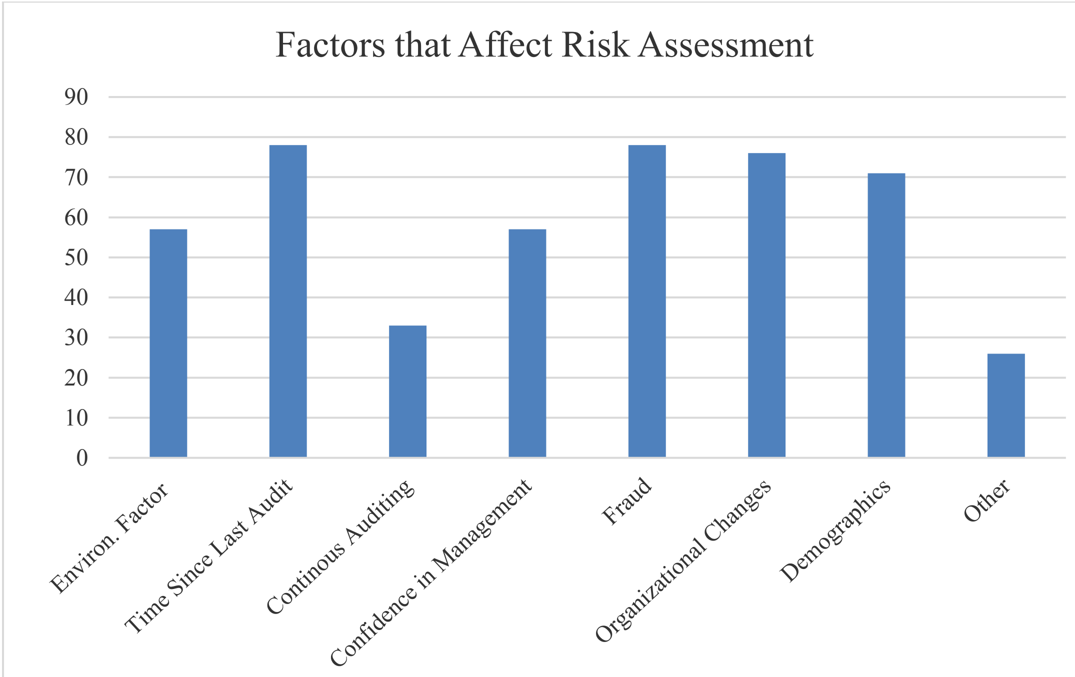
Risks in the public sector tend to concatenate because of the nature and size of operations and activities involved. When events occur in the public sector, a chain reaction is triggered that can only be effectively contained if risks are properly assessed and controls implemented to mitigate the risks. According to Stanton and Webster (2014,

p. 3) the fallout from the events of September 11, 2001, Hurricane Katrina, the BP Oil Spill and the 2007-08 financial crisis, to name a few, underpins this interconnectivity and showcases the importance of risk identification, assessment, preparedness, and management. Adverse effects that accompanied each of these events may have been avoided or at least mitigated, if risks had been properly identified and assessed. While risk and control are fundamental to the governance process, risk management in public organizations (Stanton & Webster, 2014, p. 7) can be challenging due in part to the lack of continuity caused by the policy makers' short tenure in office, and the attendant low to average quality of management skills of their political appointees. Election cycles have the tendency to produce different policy makers with diverse objectives that stem from obligations incurred during campaigns, pressures from constituents both as individuals and as a group, and conflicts between national and district interests (Clark, 1966, p. 12). Internal auditors, with their knowledge of risk and control models, stand in the gap to assist organizations manage the risk exposures that emerge from the fluidity in policy directions (Soh & Martinove-Bennie, 2011, p. 11).

Risk, as defined by Andersen (2006, p. 31), is the internal and external uncertainties, events, or circumstance that organizations must understand and manage effectively as they execute their strategies to achieve objectives. A robust risk assessment enables an organization to identify which risks are pitfalls and which represent opportunities (Pickett, 2005, p. 55). It also helps to evaluate and prioritize the risks in accordance with organization's risk appetite (Pickett, 2005, p. 85).

The graph below shows some of the factors that IAF take into consideration when designing and conducting risk assessment for public organizations.

Graph 3: Risk Assessment Factors Considered by Responding Organizations



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Risk assessment is very important to IAF (Pickett, 2005, p. 188) because it is the primary tool used to align its activities to organizational priorities, which helps determine where the key risks and opportunities lie in the organization.

With the standards serving as the architecture to provide oversight services to organizations, auditors use a systematic organizational-wide risk assessment that includes risk factors peculiar to each organization, in order to identify and calculate the probability of risk occurrence and the potential loss associated with each occurrence (Moeller & Brinks, 2009, p. 118). Risk assessments are also used to identify opportunities for improvement, mission criticality and revenue enhancement (Gantz, 2014, p. 29). It serves as a guide for the assignment of audit resources to areas with high risks and those with activities that may affect the achievement of organizational objectives enabling management to effectuate a healthy organization.

Role of IAF in Fraud Prevention, Detection, and Investigation

Although the determination of whether an act is considered fraud is beyond the internal auditor's professional responsibility, both GAS and the IPPF require an assessment of the risk of fraud within the context of the objective of all engagements. Internal auditors must have sufficient knowledge to evaluate the risk of fraud but are not expected to have the expertise of a person whose primary responsibility is the detection and investigation of fraud (Dubis et al., 2009, p. 13). Fraud is defined as "any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage" (Dubis et al., 2009, p. 4). For the purpose of this study, emphasis will be placed on fraud likely to be perpetrated in a public organizational setting. The Association of Certified Fraud Examiners (ACFE) uses the term "occupational fraud" as an umbrella term for all employee related fraudulent practices. It defines occupational fraud as the "use of one's occupation for personal enrichment through the misapplication of the employing organization's resources or assets" (ACFE, 2014, p. 6). The types of fraud prevalent in public organizations are perpetrated through corruption, asset misappropriation, and intentional misstatement in financial reporting.

Although management is ultimately responsible for the establishment and maintenance of an effective internal control system, IAF is an integral part of preventing and detecting fraud through its continuous review and evaluation of the control mechanism (Dubis et al., 2009, p. 2). Because internal auditors are employed by the organization as management's strategic partner (Dubis et al., 2009, p. 11), they possess the overall familiarity with an operating unit's business processes, internal and external relations, and fraud exposure. Equipped with this knowledge, IAF can assess the fraud risks involved in organizational operations, prioritize the probability and impact of fraud, and design its audit plan accordingly.

In addition to evaluation of internal controls and assessment of fraud risks, IAF can also provide management with an avenue for employees to raise concerns about fraud without fear of jeopardizing their jobs. A confidential process such as hotlines can be established within IAF that provides employees cover over retaliation within the hierarchical structure. To the point where a formal complaint can be lodged with the appropriate authorities, management can also take advantage of the analytical and evidence gathering skill of internal auditors in areas where fraud is suspected (Dubis et al., 2009, p. 27). Of the 104 audit organizations surveyed, 74 respondents indicated that they perform fraud audits and investigations. Forty (40) audit organizations reported performing a fraud audit or investigation during the survey scope.

Internal Controls

"Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance" (COSO, 2013). Another definition as given by Gauthier (2004, p. 1) is that internal control is "a coordinated set of policies and procedures that reflect a comprehensive strategy for achieving management objectives." Internal controls are designed to provide reasonable and not absolute assurance (Moeller & Brinks, 2009, p. 24) that management has created a framework that is conducive for the achievement of objectives. Gauthier (2004, p. 2) argues that it establishes a control environment, control activities, assesses risks, and monitors activities to ensure the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulation . Management is ultimately responsible for the design, implementation, monitoring and reporting of internal controls in an organization, while IAF assist management in meeting these roles through evaluations and assessments of the effectiveness of control systems (Moeller & Brinks, 2009, p. 25). For the overall system of internal control to be considered adequate and effective, an evaluation must include a review of the effectiveness and efficiency of operation, the reliability of financial reporting, and the compliance with applicable laws and guidelines.

Consulting or Non-Audit Services

It can be easily argued that recommendations from assurance services should be considered as consulting services (Churchill, 1966, p. 134) since they provide advice on how to correct a deficiency, error, or an adverse condition noted in the engagement (Moeller & Brinks, 2009, p. 636). Internal auditors, by nature of being an integral part of an organization, develop a deep knowledge and understanding of functions and can provide sound advice on programs and processes. Adams et al. (2012, p. 73) defined consulting as “advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization’s governance, risk management, and control processes without the internal auditor assuming management responsibility.” Internal auditors can serve as consultants in various capacities (Pickett, 2005, p. 143) including assisting department in business process improvement, continuous monitoring, and control self-assessments. They can also be engaged to conduct ethics and/or internal control trainings. Compromise of independence and objectivity is the inherent risk for IAF when operating in a consulting capacity (Williams, 2002, p. 5; Moeller & Brinks, 2009, p. 636). It is a delicate balance which audit organization must be sure to strike if they are to engage in consulting. It is therefore imperative that internal auditors understand they cannot cross the line between being advisors and doing management's job. For example, they can offer advice on opportunities for improving operations or reengineering initiatives but cannot participate in the implementation because such participation give IAF ownership of the results and jeopardizes its independence to audit the organization at a later date (Pickett, 2005, p. 79-80).

Whereas most assurance service involve a third party, which are the stakeholders who may use the information in the report to make decisions, consulting has a one-on-one relationship between IAF and the requesting department (Pickett, 2005, p. 144). When IAF is acting as a consultant, the relationship is between the activity management and the auditor. The understanding is that the activity management is the only party that receives value from the engagement. An example is a request by the Finance Department for IAF to review the segregation of duties in Accounts Payable. Another distinction between assurance and consulting services is that the auditor has the responsibility to set the scope of an assurance engagement while the client sets the scope and objectives when IAF is engaged in a consulting activity.

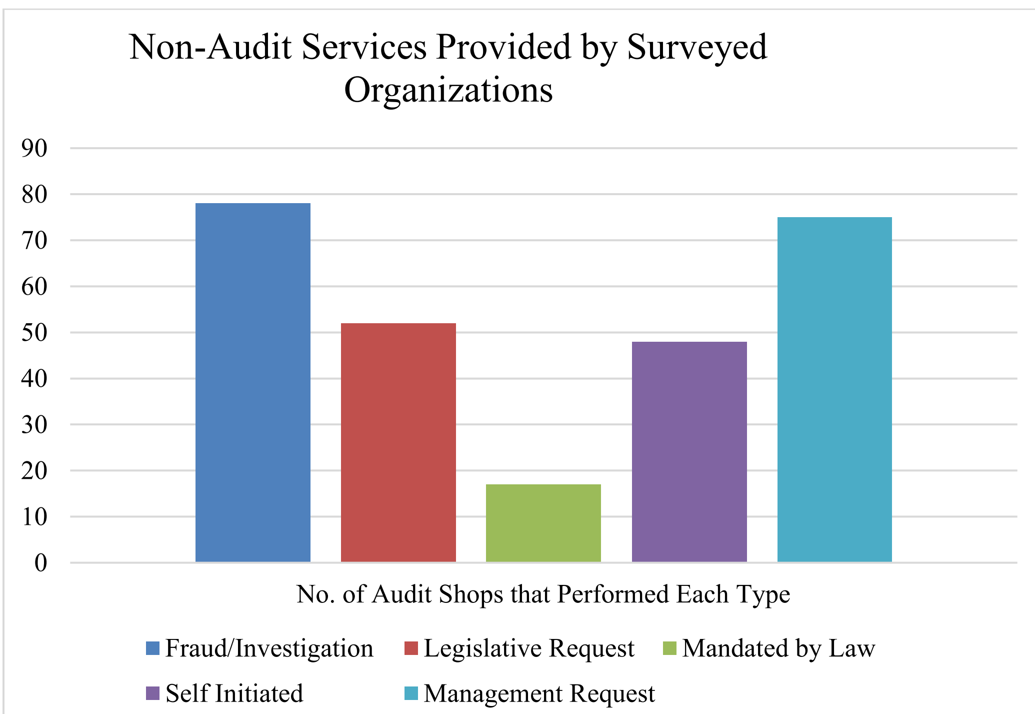
Below is both a table and a graph showing the non-audit services provided by the surveyed audit organizations, categorized by type of services and the number of audit shops that performed each type (n = 104).

Table 4: Non-Audit Services Provided by Surveyed Organizations

Types of Non-Audit Engagements. Referred to by GAO as Non-Audit and IIA as Consulting	No. of Audit Shops that Performed Each Type
Fraud/Investigation	78
Legislative Request	52
Mandated by Law	17
Self-Initiated	48
Management Request	75

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Graph 4: Non-Audit Services Provided by Respondents



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Chapter III

METHODOLOGY

The better part of this study was intended to describe what is known about IAF and to establish the need for further intellectual advancement in the area. We have been apprised of the history, activities, influence, and the effect of IAF on efficiency in public organizations. This chapter is divided into four sections which describe the research design, data source, outcome variables and analytical procedures. The objective of this section is to describe the methods used to statistically analyze the data obtained as a means to explain its application to the research topic. The aim is to use quantitative information to determine if and to what extent internal audit has contributed to the financial efficiency and effectiveness of programs and processes within public organizations. Specifically, it will attempt to determine the financial impact that controls recommended by internal audits have had on the attainment of organizational objectives and the deterrence of intentional and unintentional abuse or misuse of organizational assets. Recommendations made by IAF vary in form ranging from suggestions to mitigate deficiencies in internal control to improvements in operational efficiency and fraud risk management. To establish a relationship between IAF, recommendations and organizational goal achievement, the selected method of analysis must not only be sufficiently rigorous but should also be conceptually and theoretically grounded (Rudestam & Newton, 2015, p. 30). Thus, a quantitative expression of savings attained and revenues gained is necessary for a thorough appreciation of its significant addition to the achievement of organizational strategies and goals. As described by Remler and Van Ryzin (2011, p. 151), quantitative data is measurable information recorded and stored in numerical form. The use of statistical tools to analyze the quantitative variables extracted from the data gathered will help clarify the correlation between IAF's contribution and organizational goal achievement.

To measure for effect of IAF on efficiency in the public sector, the study uses a simple regression to the responsiveness of Number of Recommendations Accepted by Management to Audit Department Funding and the correlation between Total Audit Department Funding and fraud prevention, detection, and investigation.

Measurement of the financial impact of IAF recommendations included in an audit report (Maali, 2013, p. 16) will increase the understanding and importance of internal audits and also further the discourse on how to make the best use of IAF resources in organizations. Dollar measurement for this study will include data collected from calculations of savings from improved efficiencies, accounts payable and accounts receivables transactions, and non-compliance fines and assessments averted (ALGA, 2015).

It should be noted that overreliance on statistics may prevent the reader of this study from fully appreciating other socially significant contributions of IAF in the public sector. Because of the nature of the goods and services delivered by the public sector, it is critical to understand that the full effect of IAF on public organization cannot be completely captured quantitatively. Below is a description of the research design, data source, and the analytical procedures that were utilized to reach the results.

Research Design

The choice of a quantitative method of analysis is logical since the study is designed to produce a correlation between internal audit recommendations and organizational efficiency. As articulated by Rudestam and Newton (2015, p. 35), correlations depend on comparing two distributions of scores that are broadly dispersed along two dimensions. As tempting as it was to have wandered off into a mixed method analysis and solicit both qualitative and quantitative data about the subject, the researcher understood that the empirical method will starkly portray the relationships and patterns that exist between the variables. The study utilize the positivist approach to draw logical inference between IAF recommendations accepted by management and efficiency.

To test Hypothesis 1, this study uses a simple trend line to examine the Number of Recommendations Accepted by Management as it relates to Total Projected Dollar Savings. For Hypothesis 2, it utilizes a simple regression to test the relationship between Audit Department Funding and Number of Recommendations Accepted by Management while Hypothesis 3 also uses simple regression to test the relationship between Audit Department Funding and Number of Fraud Audits Completed.

Data Source

The study utilize secondary data obtained from the Association of Local Government Auditors (ALGA), an organization committed to enhancing public sector auditing through education, advocacy, and training. Its membership is composed of auditors from cities, counties, school districts, water districts, tribal organizations, and many more local government outfits around the world. ALGA is a common interest organization staffed by voluntary member auditors. These volunteers collect and collate information on different issues such as organizational structure, audit activities, funding, fraud and IT audits and salary. ALGA conducts these biennial surveys to provide its members a standard against which to measure their organizations. The organization has yet to statistically analyze the data with a hypothesis to produce the impact or lack thereof of IAF on public organizations.

The data was gathered as part of a benchmarking and best practices survey for participant auditors in an attempt to understand the structure and activities of member organizations. The homogeneity in the survey respondents is critical in deriving a result that will support or reject the hypotheses. Ensuring that all the respondents were public sector auditors limits the responses to like or similar recommendations since the entities audited are comparable.

Being careful to follow a logical and consistent process and with the knowledge that ALGA conducted these biannual surveys to benchmark the structure and practices of public audit offices, it was pragmatic for the researcher to select only responses to questions designed to solicit answers aimed at creating a testable set of data for the proposed hypotheses. These surveys included questions on the size of the audit department, the types of audits conducted, number of recommendation given, the number of recommendations implemented, the cost saved, efficiencies gained, and the revenues enhanced. It is noteworthy to mention that structure and construction of the survey questions took into account that the respondents were participating in a study which could influence how their profession is viewed.

These surveys were administered electronically with a tool that allowed for customized questionnaires. It was sent to Chief Audit Executives (CAEs) of all 388 audit organizations who are members of ALGA. Although the responses were received by ALGA, the raw data was forwarded to the researcher and then subsequently tabulated and grouped to allow compatibility among audit departments with similar staffing levels, budget, governance, and types of audits conducted. The researcher was also responsible for the data cleansing, editing process, and conversion of numbers into tables and figures.

One hundred and fifteen (115) responses were received electronically, while two hard copy responses were received by ALGA through email for a total of 117 (n = 117). Of the respondents, 13 were eliminated due to duplication or incomplete answers leaving the researcher with a total of 104 (n = 104). The respondents consisted of 14 audit organizations that were staffed with 1 or 2 auditors, 36 that were had between 3 to 5 staff auditors, 29 that had between 6 to 10 staff auditors, 14 that had between 11 to 15 staff auditors, and 11 that had over 16 auditors on their staff.

The table below shows responding audit organizations with their corresponding staffing levels.

Table 5: Staffing Levels of Responding Organizations

	No. of staff auditors	Number of Responding Audit Organizations	% to n = 104
	1-2	14	13%
	3-5	36	35%
	6-10	29	28%
	11-15	14	13%
	+16	11	11%
Total		104	100%

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

The survey administered for this study asked questions that were tailored to solicit information on adherence to audit standards by audit organizations. This data was intended to show competence of audit personnel. Of the 104 respondents, 98 (94%) indicated they followed at least one auditing standard. Of the ones that follow standards, 79 (76%) responded that they conducted their work under the GAS (Yellow Book), 19 (18%) utilized the IIA (Red Book). Twenty seven (26%) indicated that even though they leaned heavily on one particular standard, it did not preclude them from using a combination of the GAO and IIA standards. Of the audit organizations that responded, 65 reported number of recommendations accepted and number of recommendations implemented by management. Being mindful that implementations may sometimes last over a year and understanding that the survey only requested annualized data, an analysis using the number of recommendations implemented will not depict a true picture of the full impact of said recommendations. Since recommendations accepted by management are intended to be implemented, it will constitute the variable used to measure the impact of IAF on organizations.

A collation of the data showed that 12 (12%) audit departments reported financial impact of their recommendations. Information on the dollar savings associated with audit findings from respondent organizations was statistically analyzed to measure the relationship between them and efficiency in public organizations. Outliers were removed to arrive at averages that were truly representative of the overall group. Projected dollar savings reported by respondents did not indicate the type of audits that generated the savings; thus, the category reflects revenue from performance/operational, Information Technology (IT), compliance audits, and non-audit services. A measurement of the effect of IAF's recommendation in dollars will elevate an understanding and importance of internal audits and will also further the discourse on how to make the best use of IAF resources in organizations.

Of the returned surveys, 95 (91%) supplied information on both the budget for the entire organization and funds dedicated to IAF. This data was statistically analyzed to measure how additional funding to organizational audit departments affect IAF recommendations made and accepted by management.

Outcome Variables

The dependent and independent variables to be measured as part of this dissertation are as follows:

Number of Recommendations Made (NRM)

NRM is a consideration of the average of all recommendations for process improvement, revenue enhancement, compliance, and the safeguarding of assets reported in dollars as reported by the audit departments that provided financial impact information for recommendations implemented.

Number of Recommendations Accepted by Management (NRA)

Since management is not obligated to implement recommendations made by IAF and can accept the risks associated with the finding, it is imperative to understand the number of recommendations implemented compared to the total number of recommendations made by IAF. NRA is the average of the recommendations accepted by the management of the audit shops that provided financial impact information.

Although information was collected on the number of recommendations implemented by management, it could not be used as part of the data analysis because the length of implementation times often spans several years and will not correctly reflect the impact on the organization (Goodson et al., 2012, p. 20).

Total Projected Dollar Savings

This is the projected dollar savings by the management of the audit shops that provided financial impact information through the implementation of the recommendations made by IAF. The projected dollar savings were analyzed for recommendations that were fully implemented during the survey year.

Audit Department Funding (ADF)

This is the amount of funding expended on the audit departments that also supplied data on total projected dollar saving while responding to the survey. A tabulation of the total amount of IAF funding for all responding organizations averaged slightly above $1 million, which represented approximately .06% of total expenditures of all public organizations surveyed.

Number of Fraud Audits Completed (NFAC)

This is the number of fraud audits and investigations completed by the responding organizations that also provided data for their audit department funding. The study makes the assumption that fraud prevention and detection can be directly attributed to completed fraud audits and investigations.

Analytical Procedures

To answer the questions posed by this study, three hypotheses were used to analyze the relationship between the independent and dependent variables in the data collected.

Hypothesis 1

The independent variables are the recommendations accepted by IAF which will be aggregated and referred to as the Number of Recommendations Made (NRM) and the Number of Recommendations Accepted by Management (NRA) while the dependent variable is the revenue responsiveness referred to as the Total Projected Dollar Savings (TPDS). The proposed hypothesis is outlined below:

H_1:

IAF has a positive impact on the efficiency and effectiveness of organizational activities and the reduction of fraudulent activities through the financial and operational savings attributable to IAF recommendations.

H_0 (Null Hypothesis):

IAF has no impact on the efficiency and effectiveness of organizational activities and the reduction of fraudulent activities through the financial and operational savings attributable to IAF recommendations.

This study explores the relationship between the recommendations for improvement made by IAF with the projected dollar savings which in turn may show efficiency in processes and the value added by IAF.

Hypothesis 2

The independent variable is the amount of funding expended on the audit department of surveyed organizations which will be aggregated and referred to as Audit Department Funding (ADF) while the dependent variable is the responsiveness of Number of Recommendations Accepted by Management (NRA).

H_2:

Increase in IAF funding will result in more efficiency of processes and operations within public organizations.

H_0: (Null Hypothesis)

Increase in IAF funding will have no effect on the efficiency of processes and operations within public organizations.

Statistical Model

The linear regression model expressed below will be utilized to measure the relationship:

$y = a + bx$

where *y* is the dependent variable being predicted, *x* is the independent variable it is predicted from, and *a* and *b* are two numbers calculated by the analysis.

a is the intercept of the regression line (the value of y when x is zero) and *b* is the slope.

- Where NRA is the Number of Recommendations Accepted by Management and;
- ADF is the Audit Department Funding

Functionally this statement is: NRA = a + b(ADF)

Hypothesis 3

The dependent variable is the number of fraud audits and investigations completed by the responding organizations which will be aggregated and referred to as Number of Fraud Audits Completed (NFAC), while the independent variable is the amount of funding expended on audit departments that also supplied data on fraud audits and investigations completed. This will be aggregated and referred to as Audit

Department Funding (ADF). This will measure the correlation between the fraud audit investigations conducted to the amount of IAF funding

H_3:

The more funds organizations invest in IAF, the more likely they are to prevent and/or detect fraud.

H_0: (Null Hypothesis):

The amount of funds invested in IAF does not affect the detection and reporting of fraud in organizations.

Statistical Model

The linear regression model expressed below will be utilized to measure the relationship:

$y = a + bx$

where y is the dependent variable being predicted, x is the independent variable it is predicted from, and a and b are two numbers calculated by the analysis.

a is the intercept of the regression line (the value of y when x is zero) and b is the slope.

- Where NFAC is the number of fraud audit and investigations completed and;
- ADF is the Audit Department Funding

Functionally this statement is: NFAC = a + b(ADF)

Regression Analysis

As submitted by Freund et al. (2006), regression analysis is an application of the linear model with a view of making inferences about the relationship of the mean of the response or dependent variable to the factor or independent variable. Utilizing simple regression to predict the value of the dependent variable NRA for Hypothesis 2 and

NFAC for Hypothesis 3, a coefficient of determination r^2 was conducted. R^2 is a statistical measure of how close the data are to the fitted regression line. The dependent variable was studied to see if and how much it varies as the independent variables vary. R^2 in this analysis was used to measure the strength of relationships between the model and the observed variables. It was used to determine the distance between the observed values and the predicted value for a goodness-of-fit.

Hypothesis I

IAF has a positive impact on the efficiency and effectiveness of organizational activities and the reduction of fraudulent activities through the financial and operational savings attributable to IAF recommendations.

The attempted to quantitatively correlate the relationship between IAF Recommendations Accepted by Management and the revenue impact on public organizations. Since public organizations are not in the business of making profits, savings on processes and projects serve as a determination of efficiency. It is important to note here that correlation is not causation and this analysis is intended to support the information laid out earlier in this chapter. A relationship or lack thereof of increases in recommendations accepted with revenue accrual, combined with all other qualitative factors enumerated earlier, will help inform on the impact IAF exerts on efficiency in public organizations.

Twelve (12) audit departments reported the financial impact of their recommendations. After removing outliers such as extremely high and low, one time savings or monetary recoveries, 10 observations were used to arrive at averages that were truly representative of the overall group. Number of recommendations and the reported financial impacts were grouped, using the number of auditors employed by the responding organization. Using that information, we tested to reject or accept the hypothesis that IAF has a positive financial impact on the efficiency and effectiveness of organizational activities through the financial and operational savings attributable to IAF recommendations.

A regression model was not suitable for the data since the population of audit departments that reported the financial impact of their recommendations (n = 11) was not large enough to produce a reliable result. This study instead analyzed the data using a line chart to plot the relationship between TPDS and NRA as a set of points having coordinates determined by that relationship (see Graph 5). It is intended to show how, if any, changes in NRA affect TPDS.

Information contained in this study underpins the importance of IAF and supports the hypothesis that IAF has a positive impact on the efficiency and effectiveness of organizational activities and the reduction of fraudulent activities through the financial and operational savings attributable to IAF's recommendations. Graphically, it shows that an increase in the Number of Recommendations Accepted by Management has a positive relationship with an increase in the Total Projected Dollar Savings except in one case where 101 recommendations resulted in $367,619 in projected savings which runs counter to the observed pattern (see Graph 5).

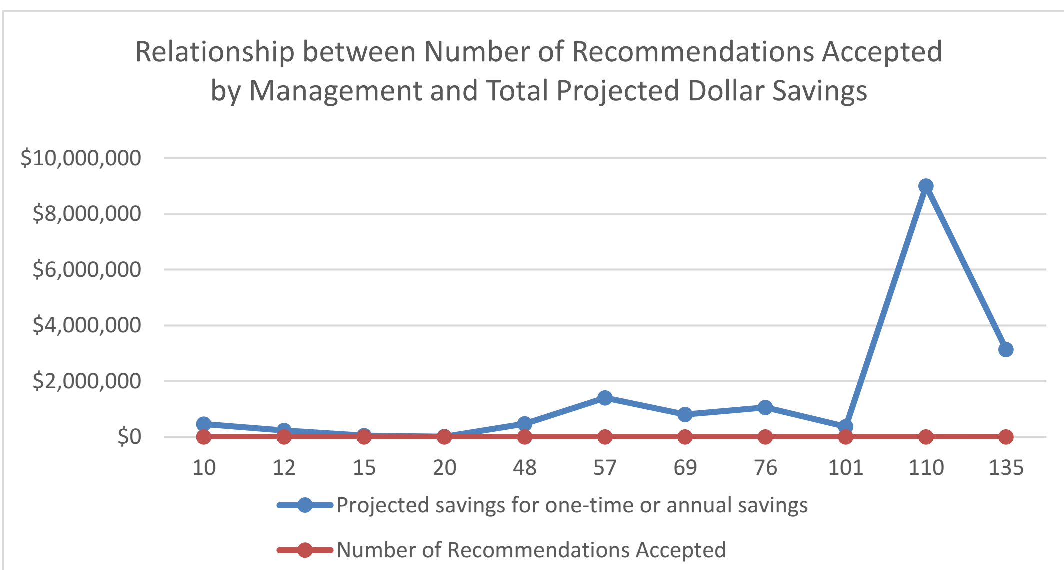
Table 6 is the data provided by surveyed organizations that track savings attributable to audit activities.

Table 6: Recommendations with Attributable Savings/Revenue Enhancements for Hypothesis 1

Number of Full-Time Audit Staff including Director, in Full Time Equivalents (FTEs)	Projected savings for one-time or annual savings	Total number of recommendations made	Number of Recommendations accepted by management
1	$50,000	20	15
1	$228,000	12	12
2	$5,783	22	20
3	$460,000	10	10
4	$800,000	70	69
4	$1,400,000	60	57
5	$367,619	101	101
6	$1,050,350	80	76
11	$466,496	48	48
20	$9,000,000	113	110
25	$3,138,200	135	135

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Graph 5: Relationship between Number of Recommendations Accepted by Management and Total Projected Dollar Savings for Hypothesis 1



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Hypothesis 2

Increase in IAF funding will result in more efficiency of processes and operations within public organizations.

The regression analysis attempted to quantitatively correlate the relationship between IAF funding and the Number of Recommendations Accepted by Management. It will measure the response of Number of Recommendations Accepted by Management to additional amount of funding expended on audit departments. Since public organizations are not in the business of making profits, savings and revenue enhancements on processes and projects serve as a determination of efficiency. It is important to note here that correlation is not causation and this analysis is intended to support the information laid out earlier in this chapter. A relationship or lack thereof of increases in Number of Recommendations Accepted by Management with funding of the audit department, combined with all other qualitative factors enumerated earlier, will help inform us about the impact IAF exerts on efficiency in public organizations.

Sixty five audit departments reported the Number of Recommendations Accepted by Management ($n = 64$). Using that information, we tested to reject or accept the hypothesis that increases in IAF funding will result in more Number of Recommendations Accepted by Management and efficiency of processes and operations within public organizations.

A regression model is suitable for the data when the points are randomly distributed around the horizontal axis. The residual plot here shows a fairly random pattern with both negative and positive residuals and indicating a decent fit for the data.

This quantitative analysis suggests that an increase in IAF funding will reflect in more recommendations accepted by management. If the logic which is supported by the last hypothesis is to be followed, it will be safe to say that more additions to IAF funding will result in increased efficiency in public organizations. Statistically, an increase in the IAF's funding has a positive correlation with the Number of Recommendations Accepted by Management. Tables 7 and 8 summarized the results of the regression analysis for Hypothesis 2.

Table 7: Regression Statistics for Hypothesis 2

Multiple R	0.65981454
R Square	0.435355227
Adjusted R Square	0.419482211
Standard Error	57.67303492
Observations	n = 64

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

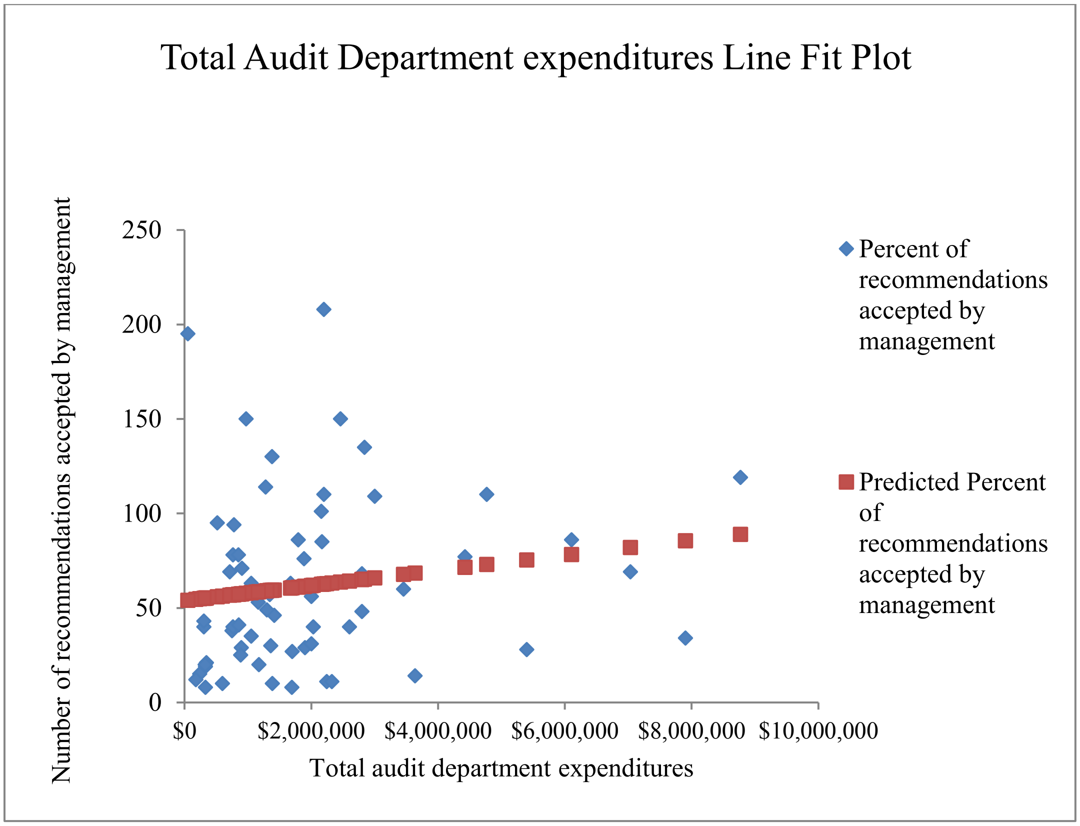
Table 8: P-Value for Hypothesis 2

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	53.81250918	8.255054229	6.518735	1.45E-08
Total audit department expenditures	4.00257E-06	3.08991E-06	1.295368	0.0199996

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

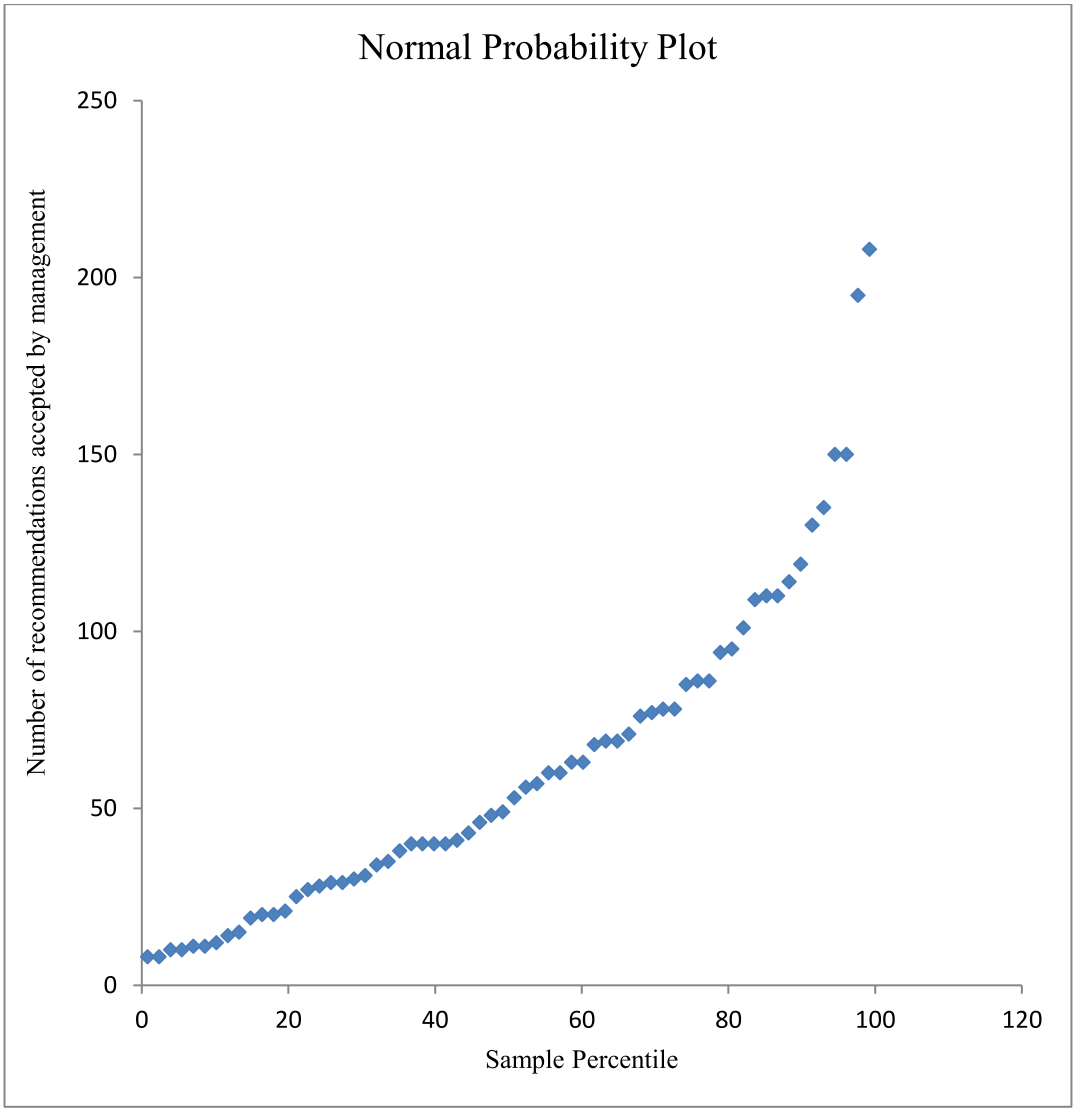
The Line Fit Plot graphs below show how the observed values fit around the regression line.

Graph 6: Audit Department Expenditure Line Fit Plot for Hypothesis 2



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

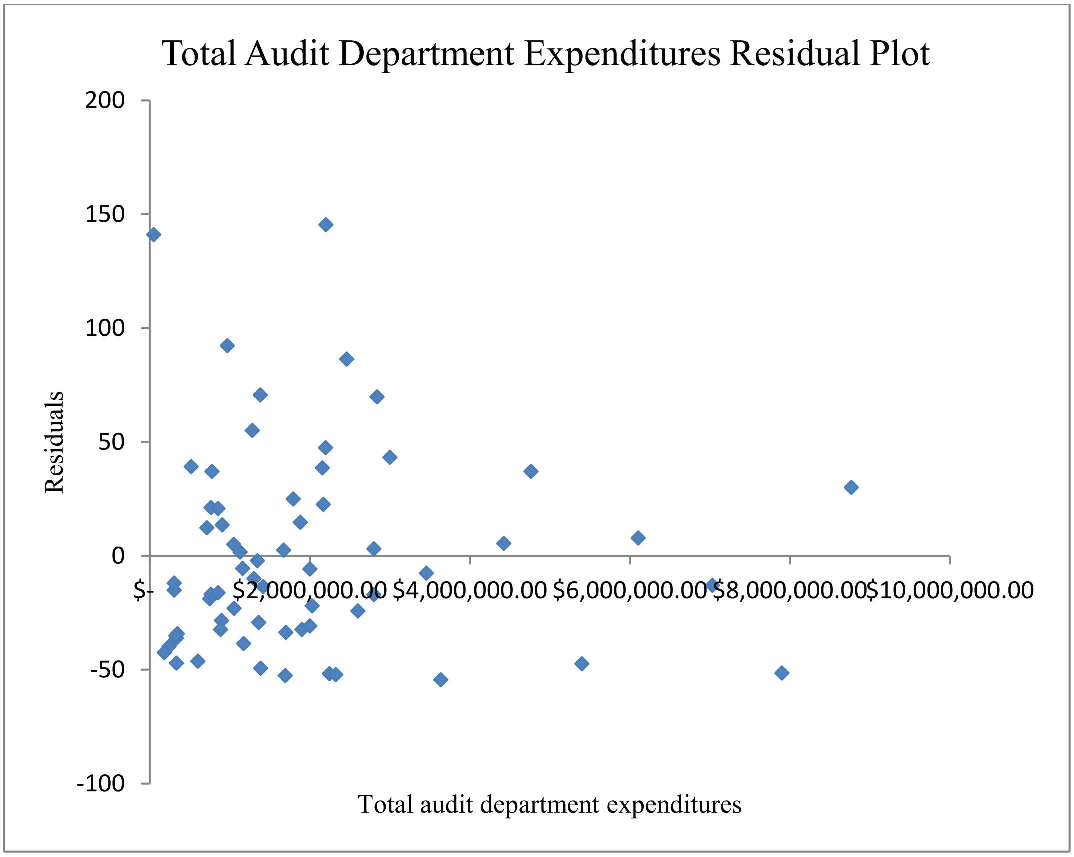
Graph 7: Normal Probability Plot for Hypothesis 2



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

The residual is the difference between the observed values and the predicted value of the model. The residual plot determines if a linear regression is appropriate for analyzing observed data. The graph is plotted with the accuracy of the prediction or residual on the y-axis and the predicted value on the x-axis to check for randomness and unpredictability. A regression model is suitable for the data when the points are randomly distributed around the horizontal axis.

Graph 8: Total Audit Department Expenditure Residual Plot for Hypothesis 2



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Hypothesis 3

The more funds organizations invest in IAF, the more likely they are to prevent and/or detect fraud.

The regression analysis attempted to quantitatively correlate the relationship between IAF funding and the number of fraud audits and investigations completed. It measured the correlation between total funding for responding audit departments to the number of audits and investigation completed. Forty (40) respondents supplied data on audit department funding and number of audits completed. Of the 40, six (6) outliers were removed to obtain observations that were representative of the population (n = 34).

Using that information, this study tested to reject or accept the hypothesis that the more funds organizations invest in IAF, the more likely they are to prevent and/or detect fraud.

A relationship or lack thereof of IAF's impact on the prevention and detection of fraud, combined with all other qualitative factors enumerated earlier, will help inform on the impact IAF exerts on efficiency in public organizations.

A regression model is suitable for the data when the points are randomly distributed around the horizontal axis. The residual plot here shows a fairly random pattern with both negative and positive residuals and indicating a decent fit for the data.

This quantitative analysis suggests a positive relationship between IAF funding and fraud prevention. If the logic which is supported by the other hypotheses is to be followed, it will be safe to say that more additions to IAF funding will result in increased efficiency in public organizations.

Tables 9 and 10 summarize the results of the regression analysis for Hypothesis 3.

Table 9: Regression Statistics for Hypothesis 3

Multiple R	0.781576508
R Square	0.610861838
Adjusted R Square	0.584546048
Standard Error	3.495266828
Observations	n = 34

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

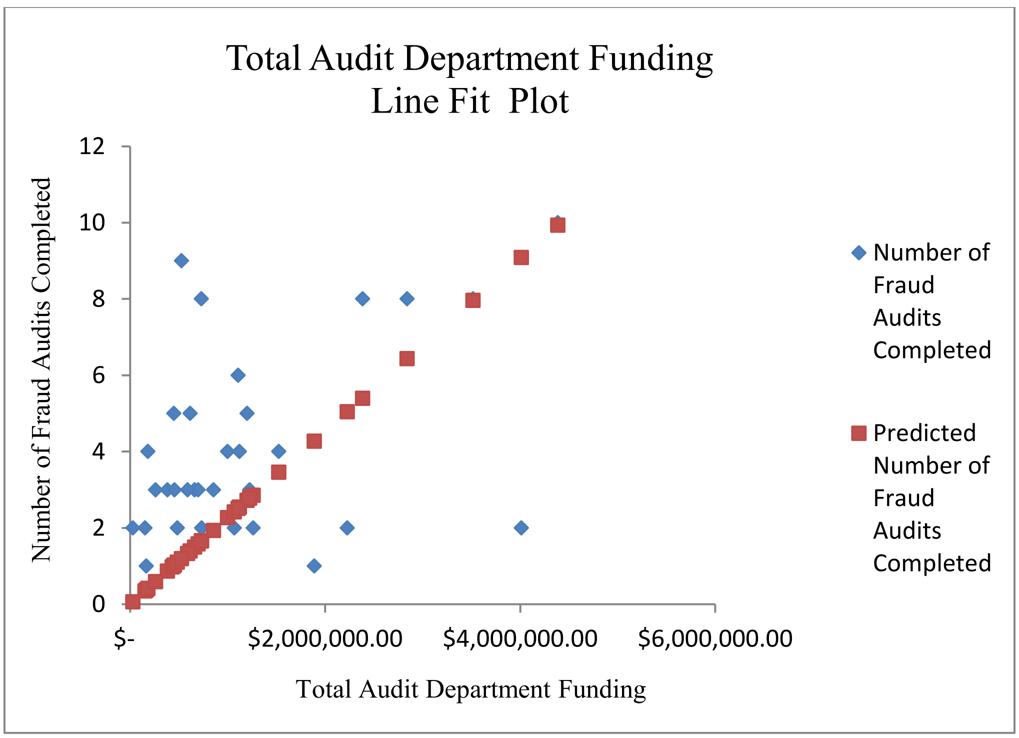
Table 10: P-Value for Hypothesis 3

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	2.666624	0.567372	4.69996	4.74E-05
Total Audit Department Funding	1.04E-06	3.56E-07	2.934662	0.006133

Source: ALGA Benchmarking and Best Practices Survey Data (2015)

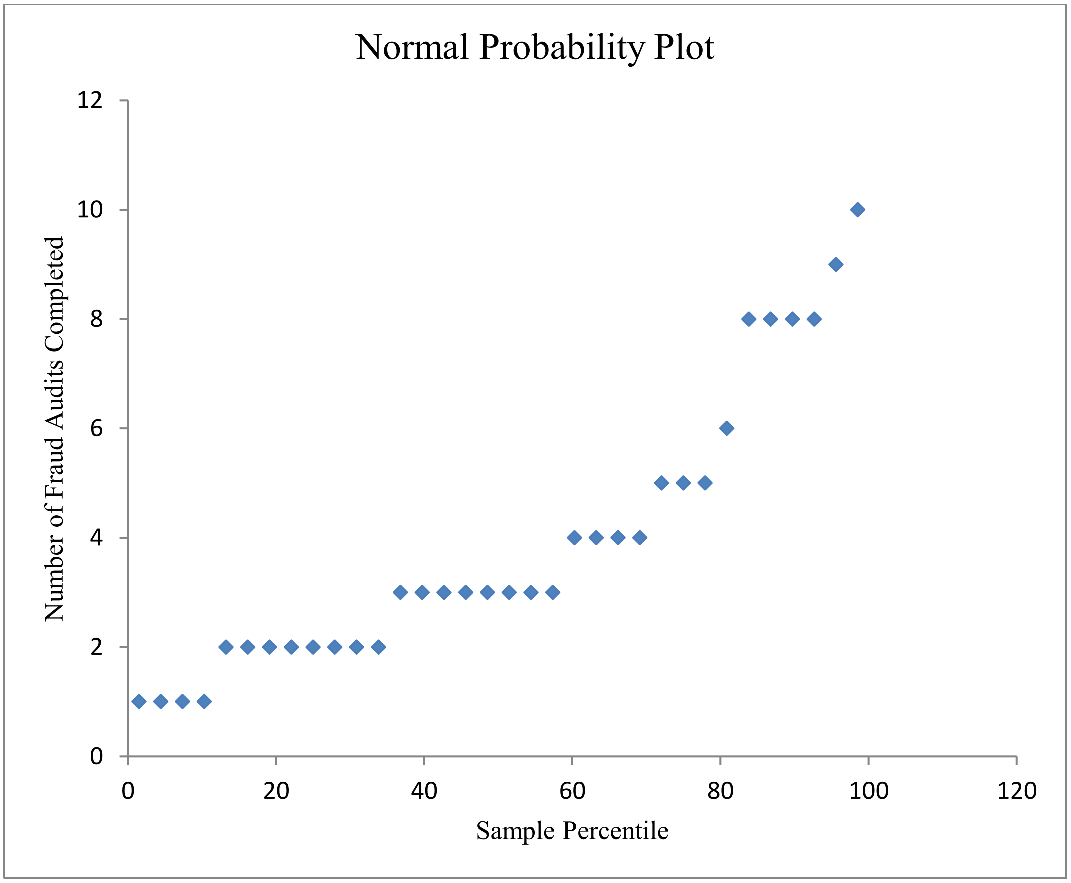
The Line Fit Plot graphs below show how the observed values fit around the regression line.

Graph 9: Total Audit Department Funding Line Fit Plot for Hypothesis 3



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Graph 10: Graph 10: Normal Probability Plot for Hypothesis 3

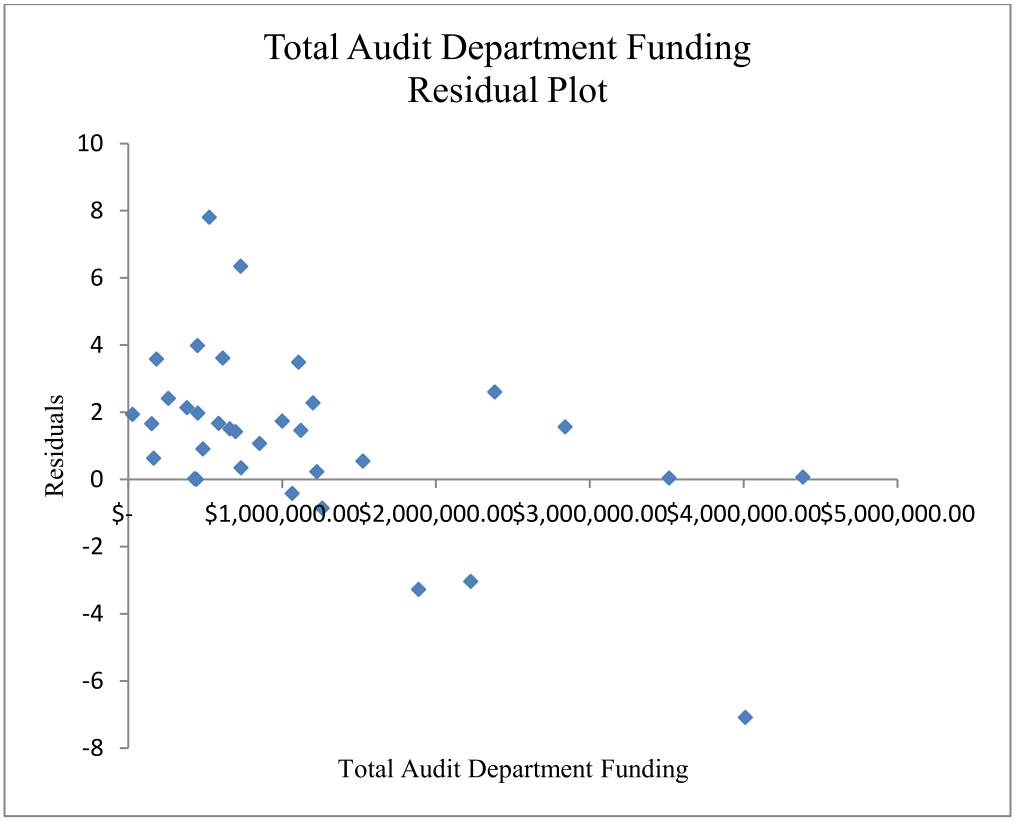


Source: ALGA Benchmarking and Best Practices Survey Data (2015)

The residual is the difference between the observed values and the predicted value of the model. The residual plot determines if a linear regression is appropriate for analyzing observed data. The graph is plotted with the accuracy of the prediction or residual on the y-axis and the predicted value on the x-axis to check for randomness and unpredictability. A regression model is suitable for the data when the points are randomly distributed around the horizontal axis.

Below is the residual plot for data observed for Hypothesis 3.

Graph 11: Residual Plot for Hypothesis 3



Source: ALGA Benchmarking and Best Practices Survey Data (2015)

Chapter IV

RESULTS

Findings for Hypothesis 1

The graph shows the responsiveness of total projected dollar savings to recommendation accepted by management. The X axis is the Number of Recommendations Accepted by Management while the Y axis is the Projected Dollar Savings attributable to IAF recommendations. The graph shows that although the Total Projected Dollar Saving was not always proportionate with the Number of Recommendations Accepted by Management, there is a relationship between the two variables. More recommendations accepted by management resulted in additional savings and revenue enhancement except in one case which ran counter to the observed pattern where 101 recommendations resulted in $367,619 in projected savings. The disproportion in TPDS' response to NRAM can be attributed to the size of the audit department and municipality which it serves. For instance a large municipality with big projects will attract more savings amount through audit recommendations than small municipalities.

Findings for Hypothesis 2

The components of the analysis that accept or reject Hypothesis 2 are:

- R which is the correlation that measures how two variable move in relation to each other.
- R^2 which indicates the proportion of variability of the dependent variable that can be explained by the independent variable.

- Adjusted R^2, the more conservative measure because it corrects for the sample size and numbers of coefficients estimated. It is said to be statistically more reliable in measuring the closeness of observed values and predicted values in the model.
- The standard error measures the variability of actual and predicted y-values.

In this analysis, the coefficient of determination (R^2) from our result is 0.435355227 while adjusted R^2 is 0.419482211. It shows that about 44% of the variation in the endogenous variable can be explained by changes in the independent variables. This implies that 44% of variations in NRA can be explained by changes in independent variables which in this case are ADF.

P-value is a measure of the strength of the evidence against the null hypothesis. It tells the researcher if the data supports the claim in the hypothesis or if the observed correlation or difference is simply by chance. The regression coefficient is positive and in the hypothesized direction. With the p-values of the Total Audit Department Funding at 0.0199996, we will fail to reject the alternative hypothesis, while the null hypothesis will be rejected.

Findings for Hypothesis 3

The components of the analysis that accept or reject Hypothesis 3 are:

- R which is the correlation that measures how two variable move in relation to each other.
- R^2 which explains the proportion of variability of the dependent variable that can be explained by the independent variable,

- Adjusted R^2, the more conservative measure because it corrects for the sample size and numbers of coefficients estimated. It is said to be statistically more reliable in measuring the closeness of observed values and predicted values in the model.
- The standard error measures the variability of actual and predicted y-values.

In this analysis, the coefficient of determination (R^2) from our result is 0.610861838 while the adjusted R^2 is 0.584546048. It shows that about 61% of variation in the endogenous variable can be explained by changes in the independent variable. This implies that 61% of variations in NFAC can be explained by changes in the independent variable which in this case is TADF.

P-value is a measure of the strength of the evidence against the null hypothesis. It tells the researcher if the data supports the claim in the hypothesis or if the observed correlation or difference is simply by chance. The regression coefficient is positive and in the hypothesized direction. With the p-value for the Total Audit Department Funding at 0.006133, we will fail to reject the alternative hypothesis, while the null hypothesis will be rejected.

Chapter V

CONCLUSION

In conclusion, this study has not only provided a quantification of the contributions of IAF to the efficiency in public organizations, it has also highlighted the criticism that has been heaped on the profession. It has shed some light on reasons for the prevalence of IAF in public organizations and will hopefully provoke further thought on the real and perceived benefits of IAF.

Through the study, we have come to learn that the general public perceives IAF as the arbiter in the dubious relationship that exists between the untrustworthy agent, who in this case is the public servant, and the principal, the taxpayer; we also learned that an overreliance on that concept may have an adverse effect on an organization; and finally, we used a quantitative approach to underscore the importance of IAF in optimization of efficiency in the public sector. Despite the argument about the efficacy of audits, the benefits outweigh the cost, and the impact IAF has on the efficiency of public organizations is enormous. Changes in public sector management, the emerging global economy, and the proliferation of risks have made auditing ever more pervasive. The suggestion here, therefore, is to temper the reliance on IAF with a measure of other factors that should produce a balanced result of the state of processes and projects in the public sector.

Limitations

The importance of IAF is demonstrated in the growing demand for the assurance and consulting services it provides and the globalization of the IIA. The general perception of internal auditing combined with the actual findings and subsequent recommendations invite the public sector into the sphere of transparency and citizen participation.

However, further inquiry is needed to validate or question the assumption or theory surrounding the profession's effectiveness in public organizations. A limitation to this study is the accuracy of dollar value assignment to the operational efficiency achieved through the recommendation offered by IAF. This can be attributed to the lack of a requirement for organizations to publish data on the financial and operational impact of recommendations made by IAF. Public sector departments and divisions are not required to calculate the dollar savings or revenue enhancements that result from implementation of IAF recommendations. The figures supplied by responding audit organizations are a combination of actual financial recoveries and those derived from the client's calculation of the revenue that accrue from the utilization of more efficient processes recommended by IAF. These computations account for both human and material resources utilized to accomplish tasks prior to implementation of recommendations compared to current usage, denominated in dollars; dollar savings through compliance to rules and regulations; and the value of organizational resources that were safeguarded from misuse and abuse. Furthermore, the limited number of audit departments that reported on the financial impact of their recommendations and fraud audit completed presented a sample risk. Low sample sizes are not always true representatives of the population being studied and may sometimes lead to unreliable findings or exaggerated effects. With only 12 audit departments reporting the financial impact of recommendations, the results for Hypothesis 1 must be interpreted with great caution. The results for Hypothesis 3 are also based on a small sample size for the number of fraud audits completed.

This quantitative analysis restricted its inquiry to the financial impact of IAF's contribution to the public organizations as calculated by the receiving agencies, department, and divisions. This study would have further benefitted from qualitative research that would entail interviews and surveys of audit committee members, senior management, people charged with governance, and other stakeholders. Although this governance in the public sector, it may also have led to highly subjective responses that are difficult to compare. Also, qualitative data would have also been very hard to collect for this study due largely to time, budget, and manpower investments.

Ethical Concerns

Parts of this research may lead the reader to accuse the researcher of a failure to banish epoche. While this argument may have some merit, it is entirely impossible for one to conduct research for this study without a preconception of the information that will be relevant for the research topic. From that standpoint, bracketing all knowledge and experience of auditing in order to create an epoche will not be consistent with the objective of this study which is to analyze the impact of IAF on public organizations. Understanding that the study was initiated to answer research questions, the researcher utilized a mind map to filter through preconceptions appropriately while suspending judgment on the phenomena under investigation.

Although this research is exempt from Institutional Review Board (IRB) oversight, all the necessary forms to validate the exemption have been duly submitted to the Office of Sponsored Programs and Research Administration (OSPRA), Valdosta State University. The federal Health and Human Services (HHS) Department and the Food and Drug Administration are charged with providing direction on the protection of rights, welfare, and wellbeing of research subjects. They in turn empower IRBs to be established at institutions that conduct research with a view to ensuring that all human subject research is conducted in compliance with federal, institutional, and ethical guidelines. According to Ritter, Kim, Morgan, and Carlson (2013) the IRBs are responsible for reviewing experimental procedures for compliance to ethical and regulatory standards.

The Valdosta State University IRB require all responsible researchers to complete the Collaborative Institutional Training Initiative (CITI) educational program, which teaches and tests prospective researchers on the reason for, and the process of compliance with, IRB requirements. This researcher completed the course on August 26, 2014, and submitted the certificate as part of the package required by OSPRA.

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