

A Conceptual Study on the Internal Audit Effectiveness in Malaysian Public Sector Agencies

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Abstract: The recurring issues of corruption, malpractices, poor public service delivery, financial irregularities and fraud always attract widespread attention. Unfortunately, although many policies and regulations have been implemented, these issues are still ongoing which make the efficacy of internal audit in the government sector even more critical than before. However, to date, it is still questionable whether this audit is efficient and effective due to the increasing trend in reported frauds in government departments. The objective of this paper is to examine the scope of audit that is associated with the effectiveness of internal audit. The uniqueness of this paper is to examine a new determinant, namely the practice of whistleblowing, on its effect in mediating the effectiveness of internal audit. The usefulness of this paper is to overcome the increasing rate of fraud in Malaysian public sector and encourage the whistleblowing practice in public sector agencies. It is undeniably very important because the public generally prefers to remain silent, thereby escalating the issues of fraud. The public may be intimidated that if they file a complaint especially towards someone more superior, or a highly-regarded person, retaliatory actions may be taken against them and this could destroy their career. Moreover, the public also believes that it is better to keep quiet rather than suffer any consequences or social pressures. The findings are expected to enhance the government initiatives in fighting frauds and corruptions through effective internal audit practice and improving the internal audit. The effect of whistle blowing practice will provide further evidence to strengthen the internal control system and practices and improve the public sector accountability and transparency.

Keywords: effectiveness, fraud, internal audit, whistleblowing practice

1. Introduction

The issues of corruption, malpractices, poor public service delivery, financial irregularities and fraud always attract widespread attention especially involving public's wealth and assets. As a counter-measure to the deficiencies in the speed and quality of service delivery and financial malpractices, in 1979 the Malaysian government had enforced the many regulations to strengthen the Internal Audit (IA) control. In spite of that, the issues of IA effectiveness are still ongoing which make the efficacy of internal audit in the government sector even more critical than before (Shamsuddin, Manijegar, Kirupanangan, Rahman & Selvanathan, 2014).

Despite the increasing importance of IA in combatting fraudulent acts and mismanagement, studies on the IA effectiveness is still lacking (Ahmad, 2015; Cohen & Sayag, 2010). Endaya & Hanefah (2013) claimed that internal auditing plays a vital role to fight against corruption and fraud. Many programs and implementations have done by internal auditor to mitigate fraud, misuse of powers as well as money

but these problems remain unchanged and unsolved. Thus, the effectiveness of IA needs to be demonstrated using a performance measurement system that accomplish stakeholder's expectations (Feizizadeh, 2012).

In the scope of audit work, progressively, the National Audit Department (NAD) is required to conduct attestation, financial management, performance and management audits of federal government companies at all levels of the governments (NAD, 2015). The main concern is, when the financial management audit was conducted, only 22.7% of public sector organizations complied with the regulations and financial management procedures. Moreover, it was also highlighted in the Auditor General Report that the weaknesses observed was on the procurement management. Issues highlighted in procurement management include the findings that works, supplies and services did not adhere to the specifications, unreasonable delays, improper building designs and green building element not functioning resulting in failure to achieve the desired objectives. These issues were of high concern to the government because they involve millions of public's money (Yusof, Haron, & Ismail, 2016). The objective of this paper is to examine the scope of audit on the effectiveness of public sector audit and to determine whether practice of whistleblowing mediates the relationship between scope of audit and the effectiveness of public sector audit.

2. Effectiveness of Public Sector Audit (EoPSA)

The increasing cases of corruption, fraud and malpractices in public sector have caused the community to have negative perceptions towards the government. Thus, it automatically reflects to the IA department because they will start doubting the government and the IA's efficacy in the public sectors. The subject is very important as internal auditing is absolutely crucial especially in an economy that relies solely on the constructed information (Peurseem, 2005). More importantly, the issue has triggered a global demand of refinement and improvements in IA's effectiveness. IA's effectiveness refers to the capability of the auditors to achieve the acknowledged objectives within the organization (Badara & Saidin, 2013). The EoPSA is determined by the importance and the role of IA which can enhance the performance and profitability of an organization. This positive enhancement is beneficial to ensure a reliable financial reporting, avoiding damage and other consequences and to prevent loss of revenues (Vijayakumar & Nagaraja, 2012). Thus, many countries have strengthened their Public Sector Audit (PSA) to improve the governments' performance and public service delivery. The effectiveness of IA correlates to the achievement of the organizations in realizing their objectives and ensure the internal control system is functional and effective (Fadzil, Haron, & Jantan, 2005).

In developing countries IA is still insufficient to contribute to the value adding service. The tasks and duties of the internal auditors in Libya needs to be broadened to extend better services to the stakeholders (Abuazza, Mihret, James, & Best, 2015). In Malaysia, Shamsuddin et al. (2014) discovered that it is not surprising that many countries are facing dilemmas in resolving various audit issues in their countries. Thus, top management and audit committee play a pivotal role to equip themselves with sound governance and accountability in their organizations. It is pertinent because the leaders should possess a higher ethical and moral values to be respected by their subordinates (Aziz, Rahman, Alam, & Said, 2015).

Recent studies on the efficacy of IA shows the trend of the studies in IA now focuses on establishing the organization's objectives and performance improvement (Ma'ayan & Carmeli, 2016). If the auditors review and contribute high-quality recommendations, the government will follow the recommendations and imitate the good actions introduced by them. On the other hand, it is contrary with Morin (2016) who argues that the auditors do not have the power to ensure that the auditees accept and implement their recommendations.

Improvement in IA can be achieved through audit activities since the auditees can learn to complete tasks correctly and be exposed to transparency in handling organizational issues and challenges (Ma'ayan & Carmeli, 2016). Whistleblowing also encourages the learning and development of the institution through the reporting of frauds and misconducts that are against the organizational goals, ethical guidelines or legislation (Skivenes & Trygstad, 2016). Overall, the majority of the prior studies incorporate the IIA standards in their measurement criteria. However, none has examined the role of the whistleblowing practice.

3. Scope of Audit (SoA)

Scope of audit in PSA consists of work of Internal Audit Unit in public sectors covers financial, compliance and performance audit. The audited departments will be audited based on these three elements that have been outlined by NAD.

Attestation and financial statement audit

One of the tasks of the internal auditors is to review the accuracy and trustworthiness of financial and operating data. They are in charge of such tasks to ensure that precise, latest, complete and necessary information record is established as well as to ensure that the record keeping and reporting are sufficient and effective (Fadzil et al., 2005). The Auditor General will validate whether the directors have fulfilled their responsibility in preparing true and fair view of financial statements and whether the records are adequately maintained and updated.

The financial statements auditing team is responsible in certifying the yearly financial statements submitted by the agencies from the public sector to be in accordance with the law and as required by the accounting standards. Across the process of auditing, the Auditor General will validate whether the directors have fulfilled their responsibility in preparing true and fair view of financial statements and whether the records are adequately maintained and updated.

Compliance audit

Compliance report is conducted to confirm whether the public-sector agencies' financial management complies with the laws and other financial regulations and procedures.

Performance audit

Performance auditing is carried out to evaluate whether the execution of the government's activities are governed in an effective, efficient and economical way and whether the planned objectives are achieved or not (NAD, 2017). In terms of Canadian context, all stakeholders are essential to be involved during the performance audits (Morin, 2016). It is argued that even though the intervention of auditors are noticeable, the performance audit did not contribute radical changes towards the organization (Desmedt, Morin, Pattyn & Brans, 2017). By contrast, from Malaysian context, it contributes big impact to the government since they are following the recommendations made seriously (Loke, Ismail, & Hamid, 2016). Since the previous paper is conducted towards the auditors' perspective, it is expected to fill the research gap by expanding it to the top management.

4. Practice of Whistleblowing (PoW)

Whistleblowing refers to the act an employee, public, supplier, customer confidentially reporting any wrongdoing in an organization (Said, Alam, Mohamed, & Rafidi, 2017). PoW has been implemented in Malaysia by introducing the Whistleblower Protection Act 2010 (WPA 2010). The WPA 2010 is a law to overcome fraud and other wrongdoings by advocating and facilitating disclosures of misconduct in both public and private sector. This act was established to shield the individuals who make such

reports of misconduct from harmful action, to provide the mechanism for the reported acts to be investigated and dealt with and to secure remedies connected with that case. In Malaysia, although this Act has been developed to provide protection for the whistleblower, the real application and implementation are still poor and the number of the researches done are still limited (Said et al., 2017).

Othman, Aris, Mardziyah, Zainan & Amin (2015) in their paper show that accountants and internal auditors in Malaysia's government are not extensively practice the whistleblowing policy. (PWC, 2014) report claimed that the implementation of whistleblowing is still not widely implemented although every organization has an effective whistleblowing. It is arguable whether the organizations encourage hotlines or web-based reporting if the stakeholders detect irregular activities in the organizations. Thus, it is advisable for the current changing environment explain very well on this issue by giving a clear communication to the public on this implementation. Contrary in the private sector, the adoption of PoW in Malaysian public listed companies is as part of revised Code of Corporate Governance, 2012 (Mustapha, Mazlina, Ismail, Hashanah & Lee, 2017). It has been argued by Ahmad, Yunus, Ahmad & Sanusi (2014) that the employees have distinctive responses to distinctive types of misconducts. Thus, there is a need of a well-structured quantitative study on examining the barriers of PoW (Razak, Noor & Zakaria, 2015).

The responsibility of IA in PoW occurs internally when the employees start reporting to the top management, promoting PoW in an organization, and conducting an investigation that is related to fraud and corruption (IIA, 2017). Subsequently, the IA will start investigating the fraud and corruption reported by the employees. Through the internal PoW, the welfare of employees and the public is secured democracy is promoted because they preserve the right of expressing the misconduct thus organization learning and development will be promoted through the reporting of these misconducts (Skivenes & Trygstad, 2016). Corruption can negatively affect the economic growth and social progress of a country as it is extremely embedded in the survival of priceless and uncertainty market mechanisms (Asiedu & Deffor, 2017). Apart from that, the PoW can be done externally. But the sequence results would probably either positively or negatively affected to the whistleblower and whistleblowing case. It is indicated that establishing a connection through communication with politician is advantageous for the whistleblower and it's case (Skivenes & Trygstad, 2016) but in certain point the reputation of the organization may be damaged (Erkmen, Özsözgün Çalışkan, 2014).

5. Conclusion

An effective IA and practice of whistleblowing assist in achieving organization's objective and many factors could influence its efficacy from within. It is important to mitigate the wrongdoings; issues of frauds and it can also help to further understand the roles of internal auditors in promoting ethical conduct in organizations. Various discussion throughout the world reveals that the effectiveness of internal audit is essential to maintain and develop high ethical nation. Moreover, an effective internal audit assist in achieving organisation's objective and many factors could influence its efficacy from within.

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