

## **INTERNAL AUDIT CAPABILITY LEVEL: PRELIMINARY STUDY OF FEDERAL AND STATE STATUTORY BODY IN MALAYSIAN PUBLIC SECTOR ORGANIZATIONS**

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### **ABSTRACT**

The purpose of this paper is to explain the importance of internal audit in enhancing the good governance of Malaysian public sector organizations. The primary objective is to determine the capability level of internal audit units of the different entities of organizations i.e. federal statutory body (CSA) and state statutory body (CSB). An explanatory case study method was used to collect the data whereby semi structured interviews, informal conversations, questionnaire and document reviews were conducted. It is found that CSA achieves overall capability level 2 with 76% achievement of key process areas (KPAs) while CSB only scores overall capability level 1 with 52% overall percentage achievement of KPAs. However, CSB scores higher percentage for respective elements of services and role of internal auditing, people management and performance management and accountability compared to CSA. Instead, CSA scores 100% achievements of KPAs for other three dimensions i.e. professional practices, organizational relationships and culture and governance structure. There is a critical need to review the dimensions of services and role of internal audit and people management, for both organizations in order to enhance the effectiveness of the IA function. Implications and suggestions for further studies are also provided.

**Keywords:** Internal audit capability, IACM, Public sector, Statutory body, Malaysia

### **INTRODUCTION**

Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations and helps an organization accomplish its objectives by bringing systematic, disciplined approach to evaluate and improve the

effectiveness of risk management, control and governance processes (Institute of Internal Auditors [IIA], 2000). The issues of globalization, transparency, integrity and improvement of government service delivery increase the need for governance and accountability, which leads to the importance of the existence of a quality internal audit function in the organisation. Internal audit emerges as an important component of management and a governance mechanism both in the private and public sectors (Khalid, 2010). The recent global financial crisis has led to questioning of how successful internal audit in its conventional role of monitoring compliance with an internal control and financial probity and its self-proclaimed role as an integral part of the risk management culture within large economic entities, whether in the private or public sector (Alzeban & Gwilliam, 2012).

The internal audit function in the public sector organizations holds a high potential for promoting accountability and improving government performance. Several countries such as Australia, Canada, and United States have developed policies aimed at strengthening public sector internal audit functions to enhance their capacity for contributing to these goals. Some of the policy measures include requiring the establishment of internal audit units; establishment of standards for the professional conduct of internal audit work; training; resource allocation; expanding reporting arrangements and broadening mandates to make auditors responsible for performance assessment (Ali, Sahdan, Saad, & Gloeck, 2012).

Internal audit unit is responsible for monitoring of internal control system as a service to management. In the absence of internal auditing practices, the management needs to apply other monitoring processes in order to ensure that the internal control system is functioning as intended. All government ministries and agencies should improve the effectiveness of their internal control system, and internal audit function because they improve good governance. In general, the establishment of internal control systems ensures effective functioning of any entities. Effective internal control system is essential for the organization's success. (Badara & Saidin, 2013). According to the Auditor General of Malaysia (2015), internal audit function plays a proactive role as a monitoring mechanism and in examining ongoing projects. It may assist public sector entities in achieving their objectives effectively, efficiently, economically and ethically by providing unbiased and objective assessments. Unbiased findings and recommendations represent critical input to good governance that can lead organizations to take prompt and appropriate corrective actions to remedy identified weaknesses and deficiencies (Ahmad, Othman, Othman, & Jusoff, 2009).

Since 2007, Auditor General Reports continuously emphasized there is a need for the internal auditors to expand and improve their auditing competencies. However, the issues of inefficiencies, ineffectiveness and other weaknesses seems to be repeating every year, which results in the loss of billions of Ringgit Malaysia of public money. Due to this, Malaysian public sector organizations have faced widespread criticism regarding their perceived lack of financial discipline, good governance and accountability (Khalid, 2010). Despite its long history and requirement in the organizations, the quality and effectiveness of the internal audit function are been questioned. Therefore, this research is important to identify the level of internal audit capability of public sector organizations. The results will be benefitting the entities studied since they will know their current level and thus will able to take next approach for achieving highest level. They will also able to determine the best level appropriate for their organization.

## LITERATURE REVIEW

### Overview of Malaysian Public Sector Organizations

Public sector contributions are very important in term of country development. It can be defined as all organizations that are not privately owned and operated, but which are created, managed and finance by the government on behalf of the public. Another definition is a political organization set up with the power to direct, regulate and control the citizen's activities to enable them to live together harmoniously and constructively, and to solve their common problems more energetically and effectively. Public sector organizations work under a strict governmental constitution, regulations, procedures and budget, they need to play their traditional roles and at the same time achieve their ultimate goal i.e. to fulfil the legality and discharge their accountability (Ali, 2015). IIA defines public sector as governments and all publically controlled or publically funded agencies, enterprises, and other entities that deliver public programs, goods, or services (Institute of Internal Auditors Research Foundation [IIARF], 2014).

In Malaysia, the structure of public sector organization comprises of several level and types of organizations i.e. the Federal Governments, the State Governments and the Local Governments as shown in Figure 1. The first two level of the governments enjoy the power in making laws and policies, while the third level only enjoy the autonomy power in term of financial and management decision making. The complexity of structure requires Malaysian government to adopt a comprehensive procedure and guidelines especially related with planning and control on the financial management matters. The main purpose is to provide an efficient and effective mechanism, thus, ensuring the proper usage and management of public resources while achieving the objectives. Hierarchy of related legal provisions is as shown in Figure 2. Continuous developments in the financial management, budgeting and accounting systems put pressure on the Auditor General to review its own techniques and methodologies in auditing so as to play a dynamic role in the accountability (Ali, 2015).

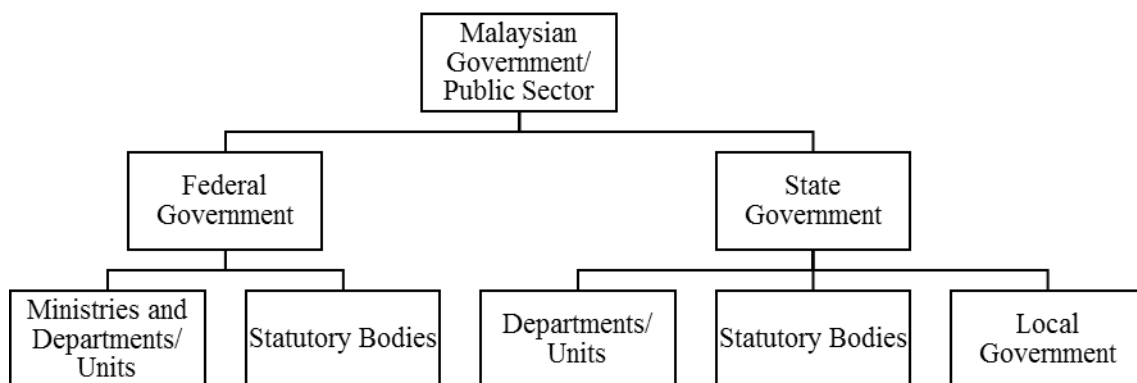


Figure 1: General composition of public sector in Malaysia (Ali, 2015).

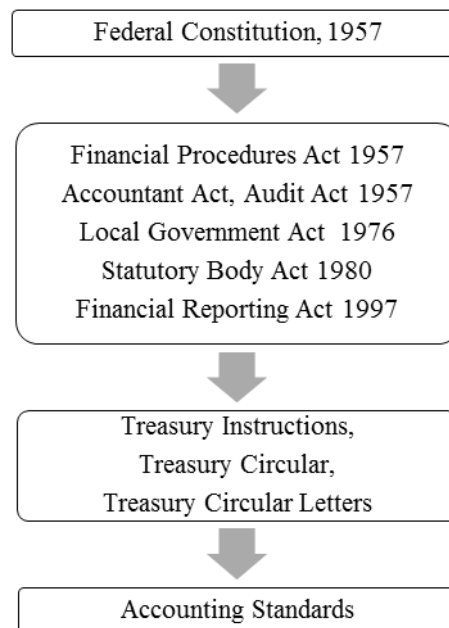


Figure 2: Hierarchy of legal provisions in financial management (Ali, 2015).

Historically, the development of internal auditing in the Malaysian public sector started in 1970 when the Ministry of Defense set up its internal audit department with limited scope of financial audit. Progressively, the scope covered both financial and management audits years later. The recommendation is documented in the Treasury Circular No. 2, 1979 which required all ministries and departments in the Federal Government to establish their internal audit unit or department. Later, the Treasury Circular No. 9 2004 was issued extending the requirement of Internal Audit function at all Ministry, Department and State Government level and to agencies and departments in the State Governments excludes the state agencies, local authorities and state economic development corporations (Ahmad et al., 2009).

In 2011, review and consolidation for all circulars were mandated under 1 Treasury Circular (1PP – 1 *Pekeliling Perbendaharaan* with two main sections i.e. PS 3.1/2013 and PS 3.2/2013. The roles and responsibilities of the Internal Audit unit, Ministry Secretary or Head of Federal Department or State Secretary and the Treasury of Malaysia are outlined in the Treasury Circular PS 3.1/2013. This circular also details the commands of internal audit duties. In Treasury Circular PS 3.2/2013, the requirements and responsibilities of the Audit Committee at both federal ministry and state government level are explained (Ministry of Finance, 2016). Specifically for Federal Statutory Body, Article 106 and 107 of the Federal Constitution and the Audit Act 1957 requires Auditor General to audit the financial statements, financial management, activity Ministries / Departments / Agencies as well as the management company of the Federal Government / Agency and submit a report thereon to the *Yang di-Pertuan Agong* for his assent before tabling them in Parliament. There are four types of audit conducted i.e. financial statement audit, compliance audit, performance audit and management of government auditing. Whereas for State Statutory Body, the requirement of internal audit unit falls under the State Secretary.

There were very few researches conducted from the Malaysian perspective with regard to the Internal Auditing in public sector even though it has important role to play in the enhancement of government agency operations efficiency and effectiveness. It is believed

that the first one was conducted by the Malaysian Institute of Accountants (MIA) in June 1988 (MIA, 1989). Another comprehensive study was published in 2007 where in-depth interviews with internal auditors from 35 states and local government bodies located in Peninsular Malaysia were conducted in year 2003 (Ali et al., 2007). This study revealed interesting findings that audit function in Malaysian state and local governments faces numerous challenges, ranging from staff (resources), skills and training shortages which contributed to the obstructions of auditors in their attempts to perform their duties. However, major questions have remained unanswered when it concerns the practice of internal audit in the nation’s federal government. Hence, a research was carried out by Ali et al. (2012) to study both the good and bad aspects of the internal auditing in the Malaysian federal government. The study disclosed that the discouraging aspects of internal audit function in the federal organizations are concerned with the inadequate number and relatively low competency of audit personnel. Both factors have then contributed to the emergence of other issues, for example limited audit scope and coverage.

The study remarked that the National Audit Department (NAD) and Public Sector Internal Audit Advisory Unit in Treasury need to improve their roles and functions in the public sectors’ internal auditing. The same study discovered that another challenge faced by public sector is the lack of uniformity in the audit practice in the public sector. The importance of uniformity in audit practice is emphasized by several auditors in their interviews. To further elaborate, the study mentioned that there is a need for uniformity among all audit units in the ministries and governmental departments, regardless of financial audit, performance audit and ICT audit. Such uniformity in concern was actually related with standardization in audit structure and audit manual across the government entities Ali et al. (2012).

There is the need to seriously consider the issue of such internal audit effectiveness, as even noted that, only few research been conducted on such internal audit effectiveness within the world (Theofanis, Drogalas & Giovanis, 2011). In line with this, some researchers stressed the need for future research to empirically examine the factors that influence internal audit effectiveness and the possible interactions among them (Endaya & Hanefah, 2013; Chaveerug, 2011; Salehi, Arianpoor & Salehi, 2013) as cited in Badara and Saidin (2013).

### **Internal Audit Capability**

Capability is seen as “the power or ability to do something” (Oxford Dictionaries, 2013). It can be said that every routine activity (Eisenhardt & Martin, 2000) with involved resources, skills and competences construct capability (Teece et al., 1997). Capability refer to the ability to implement and integrate resources to achieve corporate goals, as well as results acquired from long-term accumulation of interaction among various resources (Grant, 1995). Researchers noted that a firm’s competitive advantage may be best explained by the organizational capabilities or competencies and their application, rather than by differences in industry characteristics (Barney, 1991; Teece et al., 1997). Scholars indicate that a capability is an asset that cannot be observed (i.e. intangible) and is traded only as part of its entire unit. It can be valuable by itself, is organization-specific and imperfectly imitable (Barney, 1991; Hall, 1994). The concept of capability models has been developed over the last decade and is well accepted by organisations (Hillson, 1997; Persse, 2001; Chapman 2009) as cited in Rensburg and Coetzee (2011).

The challenge of not having a standard audit practices and assessments across the government entities leads to the deployment of the global Internal Audit Capability Model (IACM). After comprehensive research, the Institute of Internal Auditors Research Foundation, (IIARF, 2009) has developed the internal audit capability model (IACM) for public sector internal auditing. It describes a path level for a public sector organization to follow in developing effective internal auditing to meet the organization’s governance needs and professional expectations. IACM shows the steps in progressing from a level of internal auditing typical of a less established organization to the strong, effective, internal audit capabilities generally associated with a more mature and complex organization. IACM provides a tool that a public sector organization can use to (IIARF, 2009):

- i. Determine its internal audit requirements according to the nature, complexity, and associated risks of its operations;
- ii. Assess its existing internal audit capabilities against the requirements it has determined; and
- iii. Identify any significant gaps between those requirements and its existing internal audit capabilities and work toward developing the appropriate level of internal audit capability.

There are limited researches pertaining to the application of IACM model. Janse and Coetzee mapped the South African public sector legislation and guidance that are regulating the IA practices, to the IACM mode overview of the key process areas (KPAs) that has been addressed. Their research was intended to plot potential weaknesses in the government legislations and guidance as it is indirectly related to its internal audit function. The methodology used to evaluate the capability level of respective elements of IACM is by summing up the capability level achieved by each legislation and guidance. The total average of each element is then summed and average out again to obtain the overall capability level. The resulting of the mapping shows that the South African legislation and guidance achieved a total of 2.93 capability average which translates into coverage of above 50% of the overall KPAs (Rensburg & Coetzee, 2011).

In 2014, MacRae and Gils from the IIARF released a compilation report on a global internal audit survey conducted in year 2010 based on the IACM model. The survey was evaluated based on the IACM and covers majority of the KPAs based on a building-block approach aligning with the IACM concept. A total of 2824 respondents from the public sector were used as samples in this research study. The scope of the survey encompassed over 100 countries and categorized into seven regions. Malaysia and other 39 countries fall under the Asia-Pacific region. It shows that there is an improvement needed for Element 4 “Performance management and accountability” which achieved a total of 54% KPAs, scoring the lowest among the other elements. It was also highlighted that approximately 20% of respondents indicated there was no formal performance measurement of the internal audit activity. This could be a barrier to evaluate the performance of the internal audit activities. Referring to the Regional Averages by Capability Level, most of the Internal Audit from the Asia-Pacific region achieves a capability level of 2 (56%) and level 1 (35%). There is a minimal achievement of Level 3 & 4 (MacRae & Gils, 2014).

In 2015, Fern (2015) has conducted a preliminary study on the internal audit capability model of two public sector organizations in Penang State of Malaysia. The results shows that both cases i.e. Public Sector A (local authority) and Public Sector B (State Statutory Body) achieved an overall capability rating of 2 (Infrastructure) while the average percentage scores of KPAs achievement at 67% and 69% respectively. In her research, it is found that despite various performance assessments established in the Malaysian public sector, yet they are primarily focused on the overall organisation performance measurement only with lack performance tracking system established within internal audit unit. It is also found that even though there is an available performance measurement to assess the performance of internal audit units under the Ministry of Finance Malaysia purview, but it does not include the other internal audit unit in government agencies. Thus, IACM is found to be one of the framework to evaluate the capability of the internal audit unit within public sector organizations which displaying the effectiveness of the internal audit unit (Fern, 2015).

## METHODOLOGY

This research used questionnaire as primary data collection method to look at the capability level of internal audit unit. Besides that, interviews were also conducted with the head of internal audit unit/division during distribution of questionnaire in August 2016. Samples of this research were two public sector entities i.e. federal statutory body (case study A) and state statutory body (case study B). Both case studies discussed in this research were taken place in the East Coast Economic Region (ECER) of Peninsular Malaysia which hosts a large number of multinational corporations (MNCS) in the chemical, petrochemical, manufacturing, automotive and biotechnology industries. Internally generated documents made available by the head of internal audit unit– information such as the function of internal audit, internal audit charter were also reviewed. Moreover, to gain deeper insight of the practices of internal auditing in Malaysian public sector organizations, interviews with National Audit Department officers (NAD), Institute of Internal Auditors of Malaysia (IIAM) and researchers from public universities were conducted within December 2015 to March 2016.

Internal Audit Capability is measured by the self-developed checklist suggested by Fern (2015) as recommendation for future studies in her master research. Originally, the measurement is based on Internal Audit Capability Model (IACM) for Public Sector developed by the Institute of Internal Audit Research Foundation (IIARF, 2009). The questionnaires were analysed with two different measurements. The first measurement is based on the building block guideline outlined by the IACM to emphasize the establishment of an effective internal auditing function which cannot be improved if it cannot be sustained (IIARF, 2009). The outcome of the evaluation will summarize the overall capability level which is reflected from each dimension. The second measurement calculates the percentage of KPAs (Key Process Area) achievement from each dimension (Fern, 2015). Each of dimensions were evaluated for its capability levels i.e. Level 2 (Infrastructure), Level 3 (Integrated), Level 4 (Managed), and Level 5 (Optimizing) as shown in Figure 3. The six elements of internal audit capability and its KPA are as shown in Figure 4.

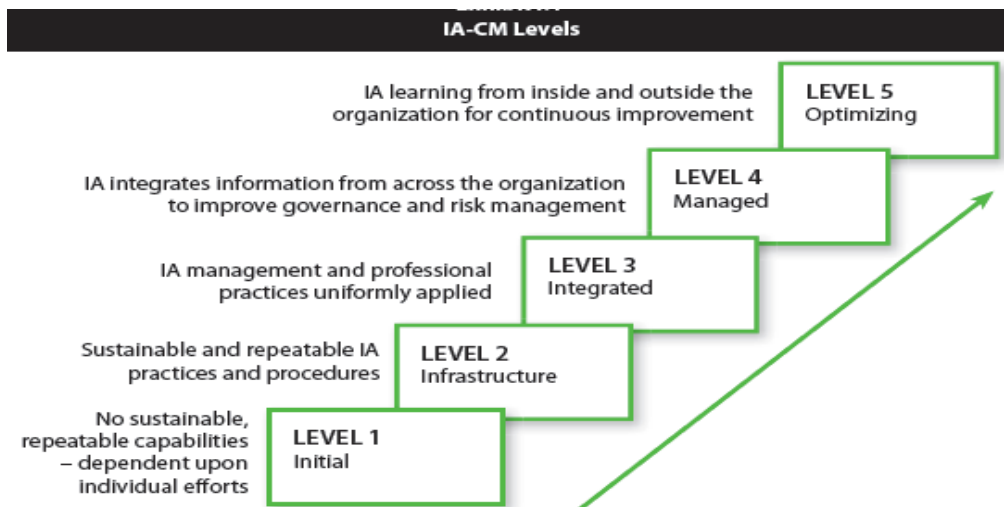


Figure 3: Internal audit capability Level (IIARF, 2009)

The first one is Services and Role of Internal Audit. The ‘services’ of internal auditing refer to the type and extent of services that the IAF provides to a government organization. Internal auditors typically provide assurance services, consulting services or a combination of the two. The types of audit engagements could include, inter alia, compliance reviews, performance audits, financial audits or information technology audits. The ‘role’ of internal auditing refers to the responsibility of the internal auditor to assist the organization in achieving its objectives and improving its operations by providing audit assessments that are independent and impartial. On the highest capability level internal auditing is recognized as a key contributor to change, specifically with regard to the governance processes of the government organization (IIARF, 2009).

‘People management’ constitutes the establishment of a working atmosphere that endeavours to promote the most effective use of internal audit human resources. On the highest capability level the IAF practices workforce projection, which involves the development of a strategic workforce plan in accordance with the strategic objectives of the government organization (IIARF, 2009).

‘Professional practice’ refers to all the policies and procedures that enable the IAF to perform its duties effectively and professionally. These include the ability of the IAF to align its own strategies with the ability of the applicable government organization. On the highest capability level the IAF practices strategic internal audit planning, which entails the adaption of the IAF’s scope of services to the government organization’s future needs. Furthermore, the highest capability level also requires that the IAF continuously endeavours to improve its professional practices in such a way as to develop its capacity (IIARF, 2009).

‘Performance Management and Accountability of internal auditing’ refers to the information required to successfully manage and control the IAF as well as the extent to which the performance of the IAF is reviewed and reported on. On the highest capability level the IAF should have public reporting structures in place to account for the effectiveness of its operations (IIARF, 2009).



	<b>Services and Role of IA</b>	<b>People Management</b>	<b>Professional Practices</b>	<b>Performance Management and Accountability</b>	<b>Organizational Relationships and Culture</b>	<b>Governance Structures</b>
<b>Level 5 – Optimizing</b>	IA Recognized as Key Agent of Change	Leadership Involvement with Professional Bodies Workforce Projection	Continuous Improvement in Professional Practices Strategic IA Planning	Public Reporting of IA Effectiveness	Effective and Ongoing Relationships	Independence, Power, and Authority of the IA Activity
<b>Level 4 – Managed</b>	Overall Assurance on Governance, Risk Management, and Control	IA Contributes to Management Development IA Activity Supports Professional Bodies Workforce Planning	Audit Strategy Leverages Organization's Management of Risk	Integration of Qualitative and Quantitative Performance Measures	CAE Advises and Influences Top-level Management	Independent Oversight of the IA Activity CAE Reports to Top-level Authority
<b>Level 3 – Integrated</b>	Advisory Services Performance/Value-for-Money Audits	Team Building and Competency Professionally Qualified Staff Workforce Coordination	Quality Management Framework Risk-based Audit Plans	Performance Measures Cost Information IA Management Reports	Coordination with Other Review Groups Integral Component of Management Team	Management Oversight of the IA Activity Funding Mechanisms
<b>Level 2 – Infrastructure</b>	Compliance Auditing	Individual Professional Development Skilled People Identified and Recruited	Professional Practices and Processes Framework Audit Plan Based on Management/ Stakeholder Priorities	IA Operating Budget IA Business Plan	Managing within the IA Activity	Full Access to the Organization's Information, Assets, and People Reporting Relationships Established
<b>Level 1 – Initial</b>	Ad hoc and unstructured; isolated single audits or reviews of documents and transactions for accuracy and compliance; outputs dependent upon the skills of specific individuals holding the position; no specific professional practices established other than those provided by professional associations; funding approved by management, as needed; absence of infrastructure; auditors likely part of a larger organizational unit; no established capabilities; therefore, no specific key process areas					

Figure 4: Internal audit capability model matrix (IIARF, 2009).

‘Organizational relationships and culture’ refers to the relational, organizational and cultural structures within the IAF, as well as the position of internal auditing within the government organization it serves. On the highest capability level, the IAF should not only have an effective relationship structure in place within the function itself, but also maintain strong and effective relationships with all the main stakeholders outside of the function, including management and the audit committee (IIARF, 2009).

‘Governance structures’ refers to the reporting structures of the IAF within the government organization. This includes the extent to which the IAF’s administrative and functional reporting structures have been established in the organization. On the highest capability level, the IAF should be totally independent, without any interference from the political or the organization’s management. The power and authority of the IAF should also be clearly in place to enable the internal auditors to perform their duties effectively (IIARF, 2009).

## **RESULT AND DISCUSSION**

### **Case Study A**

Case study A (CSA) is an internal audit unit from one of the federal statutory bodies (PSA). PSA is a public university which offers a wide range of skills-based tertiary education programmes and practical-based tertiary education in engineering, science and technology. Its research focuses on applied research and industrial projects to enrich the teaching and learning processes as well as to promote the commercialization of research products, thus exposing students to the latest research and development activities in the industries. PSA is committed to the development of human capital and technology to fulfil the needs of industries as well as to contribute to the country’s overall development.

CSA was established since 2003 and as of the time research was conducted, it holds three major portfolios i.e. internal audit, integrity unit and risk management. CSA assists and acts as a consultant to the university to ensure the resources are managed and administered in accordance with all regulations. CSA carries out the accountability index rating, financial management audits, performance audits and ICT audits.

The board of the university defined the role of CSA as a part of their supervision. In the university board meeting No 1/99, the resolution of establishment the audit committee (AC) has been approved. Three non-executive board members are appointed. AC meeting should be held at least four times a year or more based on the circumstances / necessity. CSA reports functionally to the AC and administratively to vice chancellor (VC). They communicate and interact directly with AC and is included in executive sessions and meetings whenever requires.

Under secrecy and accountability to protect records and information strictly, CSA is fully authorized and given unrestricted access to all records, physical property and any related materials while carrying out their roles and responsibilities. At least once a year, CSA must submit the audit plan to the AC and VC for review and approval. A written report will be prepared and issued by the CSA after the completion of each audit task. It shall contain management response and corrective action that has been taken or is based on the specific findings and recommendations. This report then will be sent to AC with a copy to the VC,

registrar, treasurer, legal officer and the auditee. Matters that are exposed to high risks, internal controls and governance that have not been resolved will be presented / reported to AC at the meeting. CSA is responsible to follow up on findings and actions taken by auditee upon recommendations. All significant findings will remain the key issues until resolved. A copy of the audit report that have been approved by the university Board of Directors will be sent to the General Secretary of the Ministry of Higher Education Malaysia (MOHE) to comply with the General Circular No. 3/1998 Paragraph 7.2.2 and Financial Circular No. 2/2006 Paragraph 5.

## **Case study B**

Case study B (CSB) is an internal audit division from one of the state statutory body organizations (PSB). PSB serves as the foundation to further the advancement of education, sports, culture and expand opportunities for education among citizens in the State. It aims to be the organization that is a catalyst for the development of world-class human capital which is important for the successful of Vision 2020. As of Aug 2016, there are total of 82 staffs altogether including two staff of internal audit division.

CSB was initially started in 2008 where the warrant for the post of head of internal audit and assistant auditor were issued. Until 2010, there were no personnel officially appointed to fulfil the positions even though the National Audit Department had filed this issue in their audit for Accountability Index Rating. In 2010, the head of internal audit was elected and the internal audit division started to build up their roles and responsibilities with the help of head of internal audit from state secretary office.

While undergoing this study, the proper nomination for the Audit Committee is yet to be endorsed by the Board of Committee due to the replacement of new Chief Executive Officer. Nevertheless, the current CEO gives full autonomy for the head of internal auditor to carry out auditing task due to the limited number of staffs. Operationally, head of internal audit division of CSB is reporting directly to the Chief Executive Officer. Administratively, the head of internal audit division of CSB is still at the level of assistant manager. Thus, she required to report to the head of department.

In 2014, the State Secretary Officer has given the instruction to establish the integrity unit in conjunction with the mandate given by the Prime Minister's Directive No., which is the establishment of the Integrity and Governance Committee (JITU) in all ministries, state secretaries, departments and agencies in ministry. In a clause instructed by the State Secretary Officer, for the state departments and statutory bodies without the human resource for appointment of new head of integrity unit, the head of internal audit unit must play the respective role. Since then, the head of internal audit division of PSB also serves as the chief integrity officer. Besides that, she is also given another portfolio that is to look after the investment division of PSB. Table 1 summarizes the overall findings from both case studies.

Table 1: Summary of findings for case studies A and B

Elements	Case study A	Case study B
Type of Organisation	Federal Statutory Body	State Statutory Body
Head of Internal Audit	Male	Female
Education Level	Bachelor Degree	Master Degree
Professional Certificate	Accounting – Technician Level (CAT/AAT)	Association of Chartered Certified Accountants (ACCA) UK
Membership of IIA	Yes	No
Operational Reporting level	Audit Committee	Chief Executive Officer
Administrative Reporting Level	Chief Executive Officer	Head of Department
Internal Audit Establishment	Unit	Division
Portfolio	2003	2010
Internal Audit Staff	Internal audit, integrity and risk management	Internal audit, integrity unit and investment unit
Average Years of Experience	8	2
Existence of Audit Committee	9 to less than 12 years	6 to less than 9 years
	Yes	No

## ANALYSIS AND DISCUSSION

From the analysis of internal audit capability matrix using the questionnaire answered by both head of internal auditor of CSA and CSB, it shows that CSA scored higher overall capability level 2 (infrastructure) while CSB only obtained capability level 1 (initial). CSA also scores higher overall achievement of KPA that is 76% compared to CSB (52%). CSA shows that it achieves level 5 (optimized) for four elements of IACM i.e. professional practices, performance management and accountability, organizational relationships and culture and governance structure while other two dimensions i.e. services and role of internal audit and people management only scored capability level 2. CSB only achieves level 5 for performance management and accountability dimension and level 3 (integrated) for governance structure dimension. Other three dimensions of IACM scored by CSB achieves capability level 2 while people management element scored by CSB only achieves Level 1. Table 2 and 3 illustrate the result mapping of capability level and percentage of KPA obtained by CSA and CSB respectively.

Table 2: Analysis of internal audit capability of internal audit unit in PSA

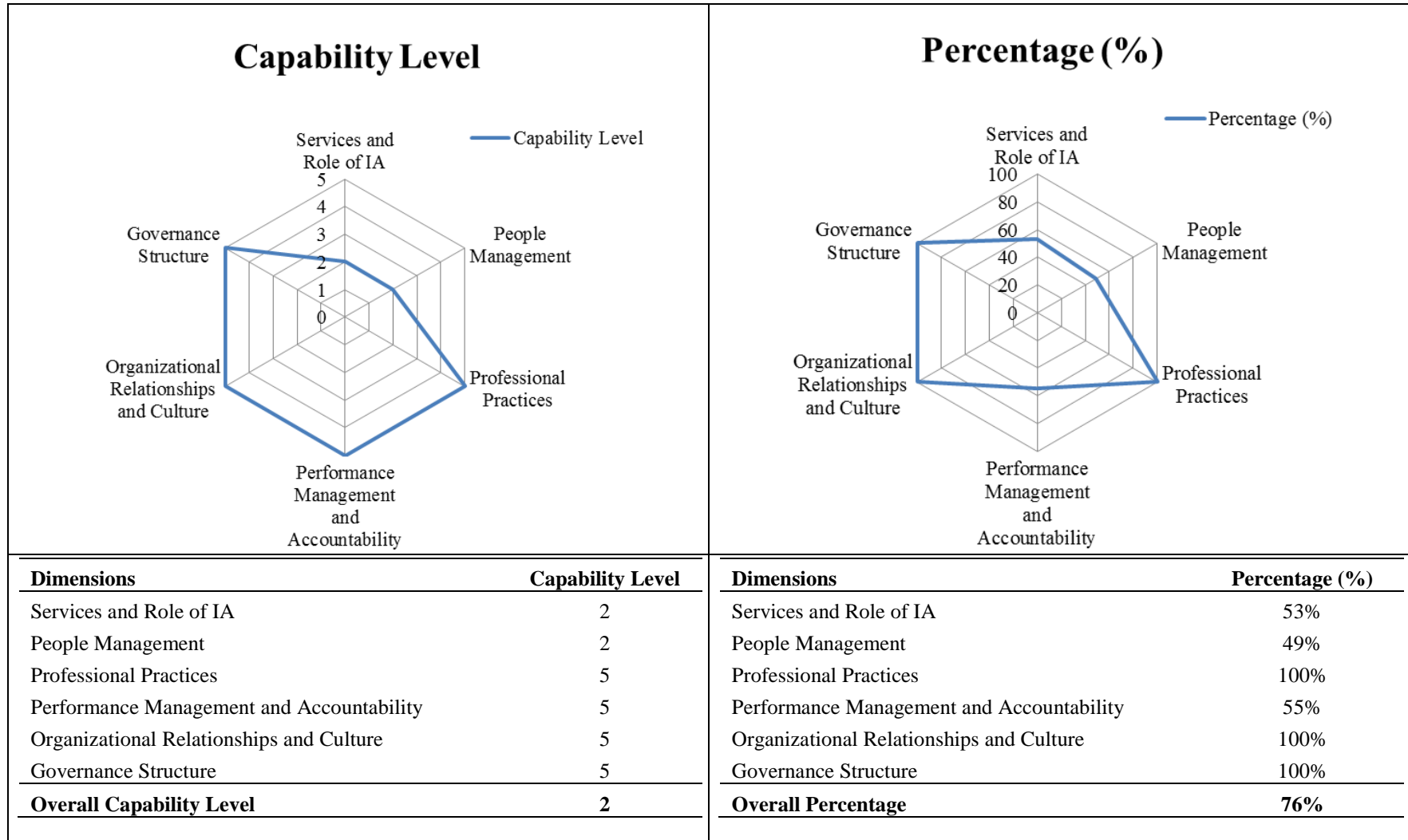
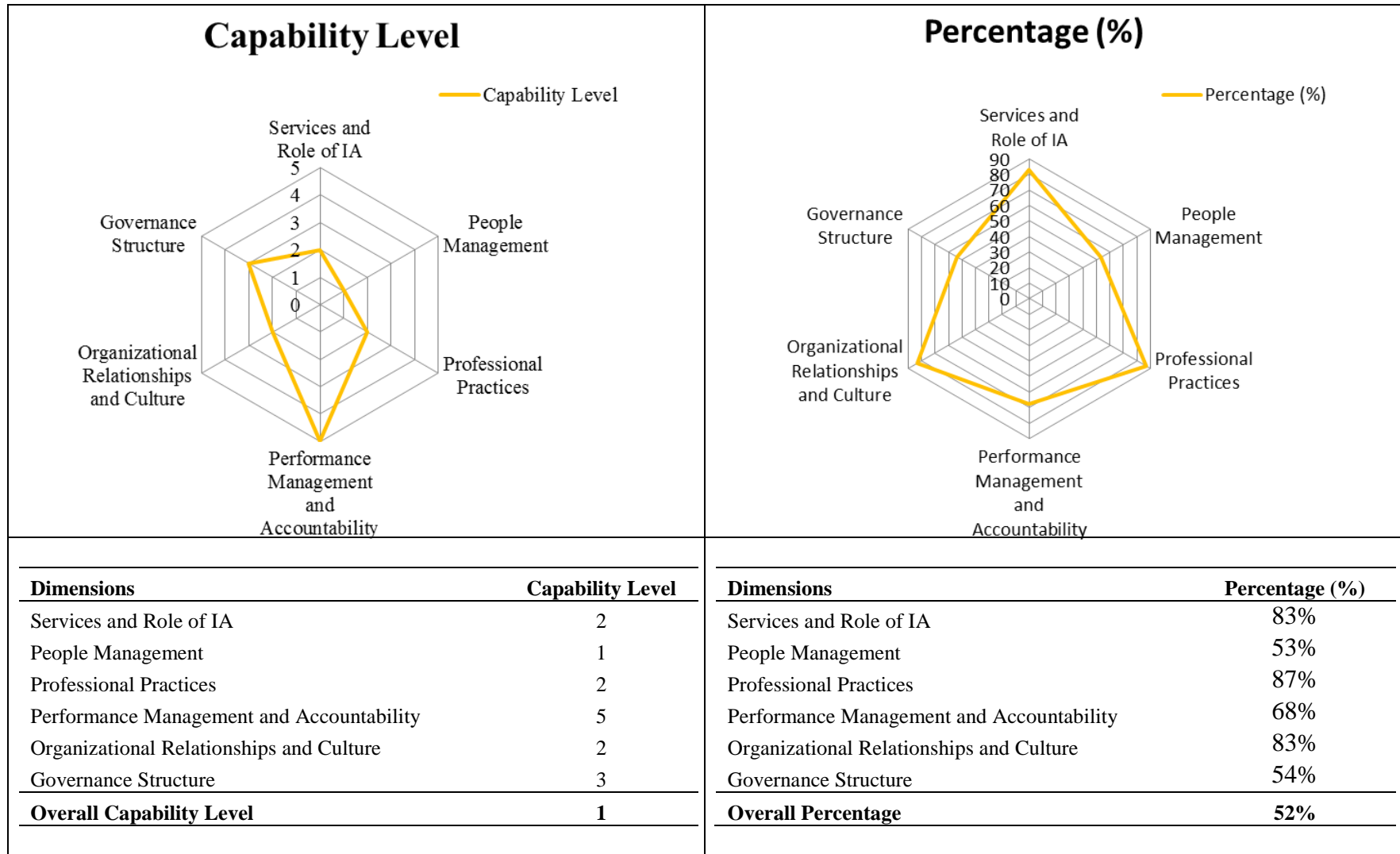


Table 3: Analysis of internal audit capability of internal audit division in PSB

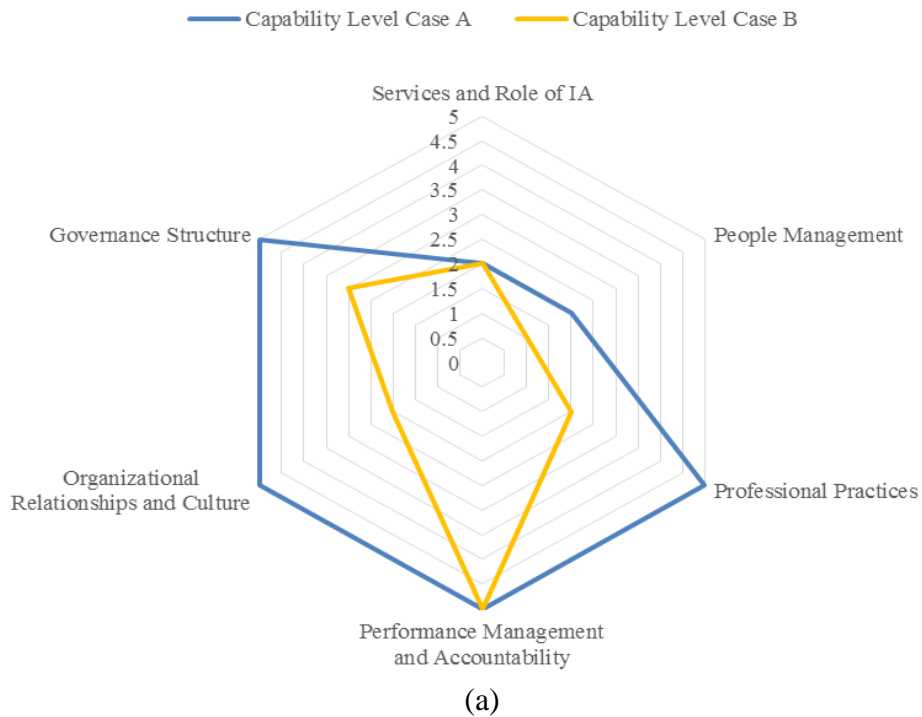


Achieving capability level 2 of services and role of internal audit dimension indicates that both cases merely reviews compliance with policies, contracts and legislation while for people management dimension, achieving level 2 shows that the IAF employs skilled internal auditors and practices individual professional development. On the highest capability level of professional practices as scored by CSA indicates that they are practicing strategic internal audit planning, which entails the adaption of the scope of services of internal audit function (IAF) to the organization's future needs. It requires that the IAF continuously endeavours to improve its professional practices in such a way as to develop its capacity while at capability level 2 scored by CSB, the IAF's plan is based on stakeholder and management priorities as well as having some sort of professional practices framework in place. As for the highest capability level 5 scored by both CSA and CSB, shows that the IAF have public reporting structures in place to account for the effectiveness of its operation performance management and accountability of internal auditing dimension (IIARF, 2009).

On the other hand, the highest capability level scored by CSA for organizational relationships and culture dimension indicates that the IAF have an effective relationship structure in place within the function itself, as well as maintain strong and effective relationships with all the main stakeholders outside of the function, including management and the audit committee. For CSB which scores capability level 2 of this dimension, it indicates that the IAF only focuses on its international relationship structures and operations. CSA scores the highest capability level for governance structures dimension which indicates that the IAF is totally independent, without any interference from the political or the organization's management. The power and authority is also clearly in place to enable the internal auditors to perform their duties effectively while CSB scores level 3 which implies that for this dimension, CSB at least meet the international auditing standard and at least have full access to the organization's data, assets and people with established reporting structure (IIARF, 2009).

From the following comparison in Figure 5, it shows that both cases achieved low level of capability for the first two dimensions of services and role of internal audit and people management. However, CSB scores higher percentage of KPAs achievement for these two dimensions (83% and 53% respectively) including another dimension that is performance management and accountability (68%) compared to 53%, 49% and 55% achieved by CSA. On the other hand, CSA scores 100% for other three dimensions i.e. professional practices, organizational relationships and culture and governance structure while CSB only scores 87%, 83% and 54% of overall KPAs achievement for each dimension respectively.

### Capability Level of PSA and PSB



### Percentage Achievement of Key Process Area

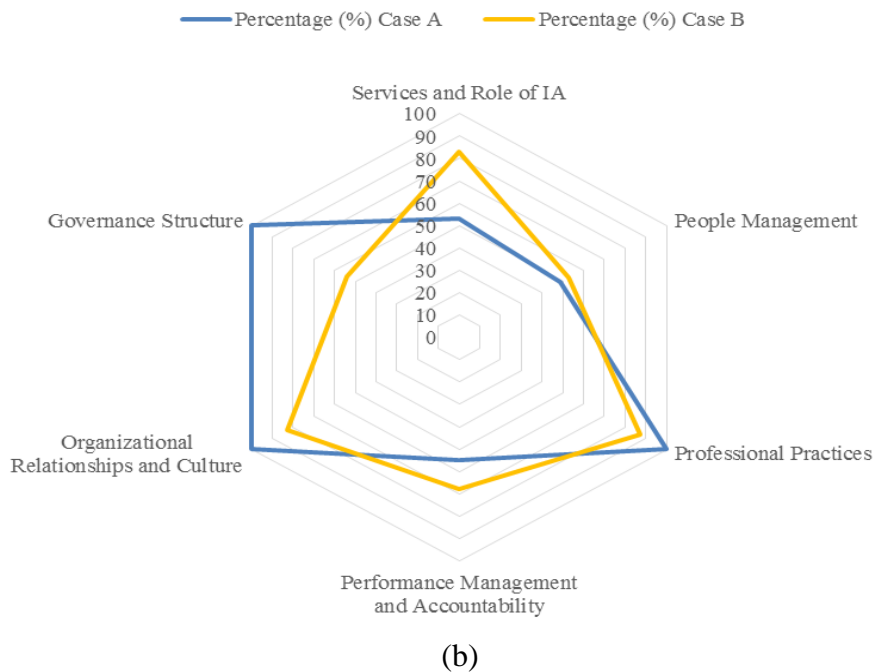


Figure 5: (a) Comparison of capability level and (b) Percentage of key process areas

The result obtained might be due to the nature of both organizations. CSA is a federal level organization that has been established since 2003 compared to CSB, a state statutory body organization that has only been established in 2010. The requirement of establishment of internal audit unit in federal level is stricter according to Treasury Circular PS 3.1 and PS 3.2



2013 while CSB may subject to the restriction / requirement from the State Secretary Office. Besides, CSB has not yet officially endorsed their audit committee. The most crucial factor that contributing for the achievement of capability level 1 by CSB is related to the professional qualification and membership. Since the IACM is developed by the IIA, the requirement of being the IIA membership is one of the elements in Key Process Areas (KPA) of people management dimension. Neither head nor staffs of internal audit CSB have such membership, which is perceived to affect the capability level of this dimension. However, head of internal audit of CSB was able to carry out her task very well with the qualification of ACCA and assistance from the head of internal audit from State Secretary Office at the earlier stage of setting up the internal audit department. Nevertheless, both CSA and CSB have scores low in people management which may impede their performance of audit services. According to Standard 2030 IPPF related to resource management – the Chief Audit Executive (CAE) should ensure that the internal audit resources are appropriate, sufficient, and effectively deployed to achieve the audit plan. Staffing plans and financial budgets, including the number of auditors and the knowledge, skills, and other competencies required to perform the audit work, should be determined from engagement work schedules, administrative activities, education and training requirements, and audit research and development efforts (Institute of Internal Auditors Malaysia [IIAM], 2008).

On the other hand, IPPF Standard 1130 stated that internal auditor should refrain from accepting responsibility for non-audit, operational functions or duties; as happened in both cases where they are required to carry out other functions such as integrity unit (both CSA and CSB) and part of investment unit for CSB. Acceptance of such responsibilities can impair independence and objectivity. Even though in IPPF Standard 1210 has stated that the internal auditors should have sufficient knowledge to identify the indicators of fraud and they are responsible for assisting the companies to prevent fraud, but it is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. Management is responsible for resolving fraud incidents, not internal auditors. Internal auditors should assess the facts of investigations and advise management relating to remediation of control weaknesses that lead to the fraud. They can also advise management in the design of a communication strategy and tactical plan (IIAM, 2008).

## **CONCLUSION AND RECOMMENDATIONS**

It is highly recommended that the internal audit unit should only focus on their auditing services, unless, they have enough staff to do otherwise. CSA should focus on how to advance the capability level of the following dimensions i.e. services and roles of internal audit and people management. They may provide individual internal audit reports the audit staff of CSA should obtain professional certifications in the internal audit profession. It is advisable for CSA to consult with the organization for special incentives to hire/retain internal audit professionals so as to compensate missing skills sets. For CSB, they may focus on enhancing all dimensions except for performance management and accountability which they has scored highest capability level. They may conduct the advisory services; become members of IIA; as well as develop team building within and across the organization. The most crucial step that CSB should take is to obtain the endorsement for Audit Committee which has yet to be done and it is highly advisable for CSB to obtain IIA membership as complimentary to the professional certificates they had.

In summary, IACM is a framework to identify the fundamental requirements for an effective IA function in the public sector. The model will be able to help assist the Malaysian public sector IA units in identifying the KPAs that are needed to establish in order to build a strong foundation of the capability level prior moving to the next. The outcomes of the IACM can then be utilized as a communication tool among the organisation, its stakeholders, at all government levels, and internationally to advocate the essential IA roles (Institute of Internal Auditors Research Foundation, 2009). If the internal audit unit able to perform effectively, the management accounting is rest assured with the control mechanism within company. Indirectly, the organizations can perform well effectively, efficiently, economically and ethically (4Es).

## LIMITATIONS OF STUDIES

In-depth studies with more generalize method and bigger sample size should be conducted. This is because this study employed case study method focusing on two organizations only, which result could not be generalized to all Malaysian public sector organizations.

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