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Internal Audit Capability Level: Case Studies of State, State Statutory Body and Public University Organizations in Malaysia

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Abstract

This paper is a part of doctoral degree preliminary study. The primary objective of this paper is to measure the capability level of internal audit units of the different entities of organizations that are state (CSA), state statutory body (CSB) and public university i.e. federal statutory body (CSC). An explanatory case study method was used to collect the data whereby semi structured interviews, questionnaire and document reviews were conducted. From the analysis of internal audit capability matrix using the questionnaire answered by the heads of internal auditor in CSA, CSB and CSC, it is found that internal audit unit in CSA and CSC both obtained capability level 2 (infrastructure) while CSB only achieved capability level 1 (initial). CSA scored the highest KPA percentage which are 82% followed by CSC (76%) and CSB (71%). Factors that may influence these results and further recommendations on advancing to the next level were discussed.

Keywords: Internal Audit, Internal Audit Capability, IACM, Public Sector, Case Study, Malaysia

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1. Introduction

Existing literature on internal audit is still limited and scarce (Roussy, 2013) in spite of a recent growing interest in this area (Pizzini et al., 2015; Trotman & Trotman, 2015; Coetzee & Lubbe, 2014; Regoliosi & D'eri, 2014; Shabnam et al., 2014), including internal audit in the public sector (Everett & Tremblay, 2014; Neu et al., 2013; Roussy, 2013, 2015; Vinnari & Skaebaek, 2014), as cited in the paper by Roussy and Brivot (2016). According to the authors, little is known about understanding and operationalization of internal audit quality by different groups of governance actors. As cited in (Badara & Saidin, 2013b), there is the need to seriously consider the issue of internal audit effectiveness since only few research been conducted within the world (Theofanis, Drogalas & Giovanis, 2011), whilst 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).

Following events such as the financial crisis and accounting scandals, the roles of internal auditing as well as internal control and its responsibilities in corporate governance and firm performance has expanded (Shenkir & Walker, 2006). The globalization issues, transparency, integrity and improvement of government service delivery increase the need for governance and accountability of organizations, which leads to the importance of the existence of a quality internal audit function in the organization (Goodwin, 2004). As such, all government ministries and agencies should improve the effectiveness of their internal control system, and internal audit function because they improve good governance (Badara & Saidin, 2013a).

According to the Auditor General of Malaysia, 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 (Ahmad, Othman, Othman, & Jusoff, 2009). Public organizations in Malaysia have faced widespread criticism regarding their perceived lack of financial discipline, good governance and accountability (Khalid, 2010). Since 2007, Auditor General Reports continuously emphasized there is a need for the internal auditors to expand and improve their auditing competencies. They are required to assess and monitor the public sector's execution and management of programs, activities, and projects to ensure that if they are being implemented efficiently, economically and if the objectives are met. However, the issues of inefficiencies, ineffectiveness and other weaknesses seems to be repeating every year, which result in the loss of billions of Ringgit Malaysia of public money. This brings the question as to what has led to these weaknesses highlighted in the Malaysian public sector organization (Ahmad et al., 2009). Prior to that, it is crucial to evaluate the capability level of the internal audit functions in the public sector organization whether they are really functioning effectively.

Capabilities relevant to the organizations' mission are crucial for the organization to be effective. These capabilities must be managed efficiently. A well-managed organization needs adequate talent to achieve its goal and prevent any failure. Correspondingly, if the resources are not utilized efficiently, it will also cause failure to the organization (Lewis, Lock, & Sexton, 2009). 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

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effective internal auditing to meet the organization's governance needs and professional expectations (Institute of Internal Auditors Research Foundation [IIARF], 2009). This paper attempts to measure the capability level of internal audit functions in different entities of Malaysian public sector organizations i.e. state, state statutory body and federal statutory body by using the Internal Audit Capability Model (IACM) for public sector as proposed by Institute of Internal Auditors Research Foundation.

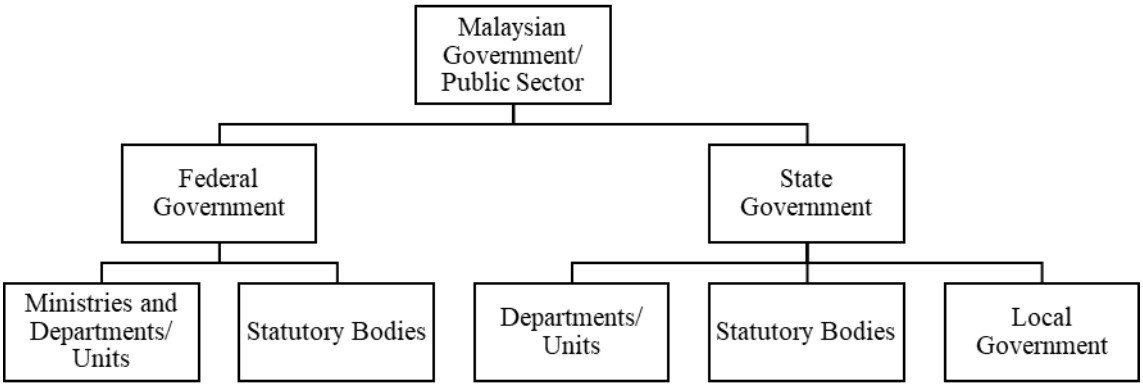
2. Literature Review

Malaysian government system is unique as compared with other federal system around the world. Malaysia employs federalism form, democratic and monarchy system of government and practiced the concept of separation power. Federalism form of Malaysian government shows three different levels of government i.e. the Federal Governments, the State Governments and the Local Governments. 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 terms of financial and management decision making. The Government of Malaysia refers to the Federal Government or National Government authority which has its base in the federal territories of Kuala Lumpur. Malaysia is a federation of 13 states operating within a constitutional monarchy under the Westminster of parliamentary system and is categorized as a representative parliamentary democracy.

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. 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. Financial management activities in Malaysian public sector comprises of such several activities such as budgeting, accounting and reporting, auditing, and performance management apart from core activities that is revenue generating and expenditure incurring. The matters regarding the financial management are stated in the constitution under the part VII: Financial Provisions. This provision comprises of 17 articles; these include the budgeting activities, financial accounting activities, reporting and auditing. 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. Auditor need to audit all the financial report and record of the government agency together with the performance audit to discharge the financial accountability entrusted to each level of government organization's and officers. 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 (E. I. E. Ali, 2015). Figure 1 shows the general structure of Malaysian public sector (E. I. E. Ali, 2015).

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Figure 1: General Composition of Public Sector in Malaysia



The requirement to adopt internal audit function in Malaysian public sector has been documented in the Treasury Circular No. 9, 2004. 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. However, the scope is limited to financial audit. Progressively, the extension of the scope has been recognized in later years where the scope covered both, financial and management audits. 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. However, the Government issued Treasury Circular No. 9 2014 to replace the 1979 circular. This circular extended the formation of Internal Audit function at all Ministry, Department and State Government level and to agencies and departments in the State Governments. However, this requirement excludes the state agencies, local authorities and state economic development corporations. This alluded to the assumption that internal audit is not a necessity in these organizations (Ahmad et al., 2009).

In 2011, review and consolidation for all circulars were mandated under 1 Treasury Circular (1PP – 1 Pekeliling Perbendaharaan). There are two main sections outlined in 1PP to describe the duties and establishment of Internal Audit function which are the PS 3.1/2013 and PS 3.2/2013. Treasury Circular PS 3.1/2013 outlines the roles and responsibilities of the Internal Audit unit, Ministry Secretary or Head of Federal Department or State Secretary and the Treasury of Malaysia. This circular also details the commands of internal audit duties. Treasury Circular PS 3.2/2013 explains the requirements and responsibilities of the Audit Committee at both federal ministry and state government level (Ministry of Finance, 2016).

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 (A. M. Ali, Gloeck, Ali, Ahmi, & Sahdan, 2007). This study revealed interesting findings that audit function in Malaysian state and local

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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 A. M. 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 same 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 (A. M. Ali et al., 2012).

Despite of its long history and requirement in the organizations, the quality and effectiveness of the internal audit function in Malaysian public sector have always been questioned. Nevertheless, there is lack of research in this area especially in determining the effectiveness of internal audit function and the measurement of effectiveness varies accordingly. In 2009, the Institute of Internal Audit Research Foundation (IIARF) had developed the Internal Audit Capability Model (IACM) for public sector after comprehensive research.

As cited in Lester (2014), capability has variously been described as about having the potential to become competent, as being similar to competence but less normative or prescriptive, as being virtually synonymous with a broad version of (internal) competency, and as encompassing competence but going beyond it in a number of ways. Stephenson (1998) describes capability as being about intelligent judgement, ethical practice and self-efficacy as well as competence; a high level of capability does not necessarily mean being comprehensively competent, but it does imply being able to know what level of competence is needed and to exercise it wisely. In their discussion of the "capable practitioner" O'Reilly et al. (1999) include the ability to go beyond what would normally be considered competent into excellence, creativity or wisdom and to be able to exercise constructively sceptical judgement about the "right" or "best" ways of doing things. Lester and Chapman (2000) comment that while competence "is typically concerned with fitness for purpose (or getting the job right), capability infers concern also with fitness of purpose (or making judgements about the right job to do)", again suggesting a conceptually higher level of operation than that typically captured in most notions of competence. Nevertheless, in all these accounts the capable practitioner is also expected to be functionally competent, while also being aware of the limits of his or her competence – and potentially how to overcome them – in any given situation (Lester, 2014).

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

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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 organizations (Hillson, 1997; Persse, 2001; Chapman 2009) as cited in Rensburg and Coetzee (2011).

The capability maturity concept to determine organizational abilities has roots in quality management since studied done by Crosby (1975) as cited in Babatunde, Perera, and Zhou, 2016. Since then, maturity models have been proposed for a wide range of activities, including software development (Bamberger, 1997; Bollinger and McGowan, 1991; Paulk et al., 1993), supplier relationships (Macbeth and Fergusson, 1994), research and development effectiveness (Szakonyi, 1994), product development (McGrath, 1996), innovation (Chiesa et al., 1996), collaboration (Fraser et al., 2002; Fraser & Gregory, 2002), product design (Fraser et al., 2001; Strutt, 2001; Williams et al., 2003), and reliability information flows (Boersma et al., 2004; Brombacher, 1999; Sander & Brombacher, 2000, 1999) as cited in (Tiku, Azarian, & Pecht, 2007). In their paper, they proposed another model called reliability capability maturity metric, which electronics manufacturers can use to evaluate the maturity of the reliability practices of themselves and their suppliers. While, in this present paper, the approach of capability model for internal audit in public sector is used. This model was approved by the IIARF (2009). It is developed based on the Software Capability Maturity Model by Software Engineering Institute (SEI).

Further cited by Rensburg and Coetzee (2011), a capability maturity model (CMM) was developed during the late 1980s to early 1990s by the SEI of the Carnegie Mellon University in the United States of America (USA) (SEI 2010). The CMM focuses on capability, maturity and business excellence (SEI 2010) and is based on a framework of process capabilities that was developed by Watts (1988). The CMM was originally developed to advance software engineering methodologies and processes using data from organizations contracted with the USA Department of Defense (Hillson 1997:36). The model has since been adapted for various other fields such as Risk and Insurance Management Society risk maturity model (RIMS 2006). The SEI model suggests that a well-structured CMM should be in the form of a matrix that comprises the following elements (Persse 2001; Chapman 2009): (a) a few levels of capability describing the stage of development; (b) the assessment criteria or attributes describing the quality of the practices within each capability level; and (c) the competencies describing the incremental improvements or desired capabilities linking the levels to the criteria (Rensburg & Coetzee, 2011).

The IACM developed by IIARF (2009) fits the SEI model which contains all the three areas set by SEI i.e. (a) Level of capability: the IACM has five progressive capability levels with a description of the characteristics and capabilities of the IAF within each level; (b) Essential elements: the IACM identifies the six essential elements that are present in any IAF; and (c) Key process areas (KPA): the main indicators that must be present within each element for a specific capability level (Rensburg & Coetzee, 2011). In summary, IACM is a framework that identifies the fundamentals needed for effective internal auditing in the public sector and consists of five levels, tied to leading practices which can be used to help evolve public sector internal auditing by strengthening its capacity and improving its effectiveness (Institute of Internal Auditors Research Foundation, 2009).

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There are still very limited researches pertaining to the application of IACM model. Rensburg and Coetzee (2011) 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).

2. Methodology

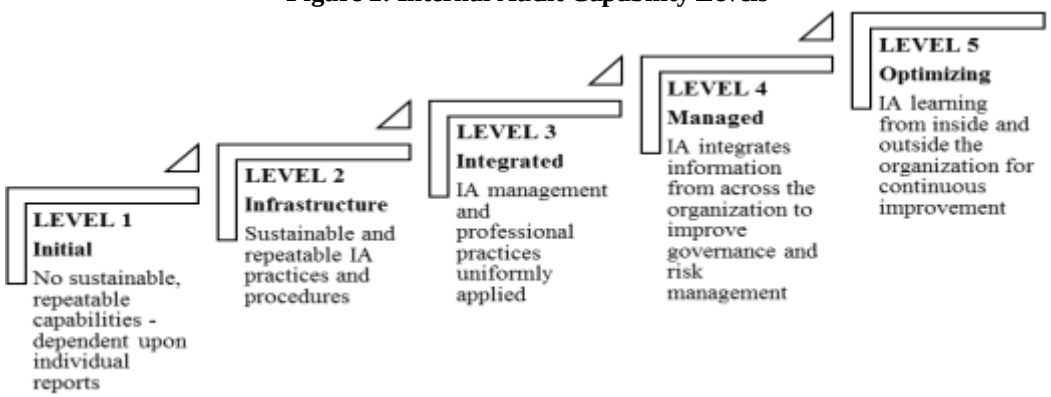
This research is a part of doctoral study. For this paper, it presents the preliminary finding of research conducted by a case study method, which looks at capability level of internal audit units at three different public sector entities that are state level organization (case study A), state statutory body (case study B) and public university or federal statutory body (case study C). All cases were located in East Coast Region of Peninsular Malaysia. Data were gathered from June until September 2016 through both primary and secondary sources i.e. (i) Interviews with head of internal audit unit. Interviews were

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conducted and all interviews were tape-recorded and transcribed for analysis. (ii) Internally generated documents made available by the head of internal audit unit– information such as the function of internal audit, internal audit charter. The documents were reviewed and (iii) Questionnaire to measure internal audit capability level was distributed to the head of internal audit of these organizations. 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 prior to meeting these selected entities that is 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. This checklist contains six dimensions of IACM elements i.e. Service and Role of Internal Audit, People Management, Professional Practices, Performance Management and Accountability, Organizational Relationships and Culture and Governance Structure proposed by Institute of Internal Auditors Research Foundation (2009). Based from these six elements, each of dimensions will be evaluated for its capability levels i.e. Level 2 (Infrastructure), Level 3 (Integrated), Level 4 (Managed), and Level 5 (Optimizing) as shown in Figure 2.

Figure 2: Internal Audit Capability Levels



Each capability level identifies key process areas and essential practices that must be implemented within the six elements of an internal audit activity identified in the model. KPAs are the main building blocks that determine the capability of an IA activity. They identify what must be in place and sustained at that capability level before the IA activity can advance to the next level. When an IA activity has institutionalized all of the KPAs associated with a given level of internal audit capability, it may be considered to have achieved that level. In other words, all of the KPAs in each element up to and including that level must be mastered and institutionalized into the culture of the IA activity for internal auditing to achieve a particular level (Institute of Internal Auditors Research Foundation, 2009). The capability maturity levels are in ascending order which indicates that an organization that intends to advance to higher levels has to fulfil higher capability levels criteria (Babatunde et al., 2016).

The evaluations of questionnaires are analysed with two different methodologies. The first measurement is based on the building block approach guideline outlined by the IACM to emphasize the establishment of an effective internal auditing function which cannot be improved if it cannot be sustained (The IIA

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Research Foundation, 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).

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. The model describes the role and services of the IAF as falling between the following two extreme capability focus points; (a) 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; (b) On the lowest capability level (level 2) internal audit auditing merely reviews compliance with policies, contracts and legislation. Level 1 is not included, as the IACM Matrix refers to this level as "ad-hoc" and/or "unstructured" (Institute of Internal Auditors Research Foundation, 2009).

'People management' constitutes the establishment of a working atmosphere that endeavours to promote the most effective use of internal audit human resources. The model depicts the people management of the IAF as falling between the following two extreme capability focus points; (a) 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.; (b) On the lowest capability level (level 2) the IAF employs skilled internal auditors and practices individual professional development. Level 1 is not included, as the IACM Matrix refers to this level as "ad-hoc" and/or "unstructured" (Institute of Internal Auditors Research Foundation, 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. The model depicts the professional practices of the IAF as falling between the following practices of the IAF as falling between the following two extreme capability focus points; (a) 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; and (b) On the lowest capability level (level 2) the IAF's plan is based on stakeholder and management priorities as well as having some sort of professional practices framework in place. Level 1 is not included, as the IACM Matrix refers to this level as "ad-hoc" and/or "unstructured" (Institute of Internal Auditors Research Foundation, 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. The model represents the performance management and accountability functions of the IAF as falling between the following two extreme capability focus points. On the highest capability level the IAF should have public reporting structures in place to account for the effectiveness of its operations. On the lowest capability level (level 2) the IAF has an operating budget and business

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plan in place. Level 1 is not included, as the IACM Matrix refers to this level as "ad-hoc" and/or "unstructured" (Institute of Internal Auditors Research Foundation, 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. The IACM presents the organizational relationships and culture of the IAF as falling between the following two extreme capability focus points ((a) 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; and (b) On the lowest capability level (level 2) the IAF only focuses on its international relationship structures and operations. Level 1 is not included, as the IACM Matrix refers to this level as "ad-hoc" and/or "unstructured" (Institute of Internal Auditors Research Foundation, 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. The model depicts governance structures of the IAF as falling between the following two extreme capability focus points: (a) 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; and (b) On the lowest capability level (level 2) the IAF should at least have full access to the government organization's data, assets and people and should have some sort of reporting structure established. Level 1 is not included, as the IACM Matrix refers to this level as ad-hoc" and/or "unstructured" (Institute of Internal Auditors Research Foundation, 2009). Figure 3 shows the matrix of IACM.

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Figure 3. The Matrix of Internal Audit Capability Model

	Services and Role of IA	**People Management**	**Professional Practices**	**Performance Management and Accountability**	**Organizational Relationship and Culture**	**Governance Structures**
Level 5 Optimizing	- 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
Level 4 Managed	- 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
Level 3 Integrated	- 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
Level 2 Infrastructure	- 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

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Level 1 Initial	No specific Key Process Areas; Ad hoc or unstructured; Isolated single audits or reviews of documents and transactions for accuracy and compliance; Outputs dependent upon the skills of the specific person holding the position; No professional practices established other than those provided by professional associations; Funding approval by management, as needed; Absence of infrastructure; Auditors are likely part of a larger organizational unit; Institutional capability is not developed.

3. Results and Discussion

Case study A (CSA) is an internal audit unit at state level (PSA). CSA has been established since 2001. The establishment of the internal audit unit is according to the mandate of Treasury Circular PS 3.1/2013 and PS 3.2/2013. CSA is responsible to other state governments departments and agencies that do not have their own internal auditors as stated in PS3/1/2013. At the moment of research conducted, there are 38 of departments under purview of CSA. The vision of the unit is to provide an efficient audit services to enhance the financial management accountability of agencies under the administration of the State Government while its missions are to conduct audits in a fair and professional manner towards enhancing the financial management accountability of agencies under the administration of the State Government. The objective of the unit is to assist agencies under the State Government Administration in achieving stipulated goals and improve the level of accountability in financial management. According to the Designation Approval Letter N153/2007 dated 31 October 2007, it was stipulated that five staffing positions in CSA has been approved. In 2015, 10 additional posts through Designation Approval Letter N105/2015 dated 29 December 2015 have been approved. These 15 audit staffs has the highest education level is degree (two staffs) and others are secondary school. None of the audit staffs has the professional accounting qualification except of the head. On average, the years of experience of the internal audit staffs are three to less than six years. The head of internal audit unit has to report functionally and operationally to the State Secretary Officer.

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. PSB 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. There are four subsidiaries under PSB which are basically related to plantation, mining and education with 82 staffs altogether. CSB i.e. the internal audit division of PSB 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 PSA mentioned in previous case study. Until recently, 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

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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 PSA.

Case study C (CSC) is an internal audit unit from one of the federal statutory bodies. It 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. The university 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. CSC 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. CSC assists and acts as a consultant to the university to ensure the resources are managed and administered in accordance with all regulations. CSC carries out the accountability index rating, financial management audits, performance audits and ICT audits. The board of the university defined the role of CSC 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. CSC 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, CSC 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, CSC 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. CSC 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.

Table 1 shows the summary of all case studies background.

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Table 1: Summary of Findings for All Case Studies

Elements	Case Study A	Case Study B	Case Study C
Type of Organization	State Government	State Statutory Body	Federal Statutory Body
Head of Internal Audit	Male	Female	Male
Education Level	Bachelor Degree	Master Degree	Bachelor Degree
Professional Certificate	None	Association of Chartered Certified Accountants (ACCA)	Accounting – Technician Level (CAT/AAT)
Membership of Institute of Internal Auditor (IIA)	Yes	No	Yes
Operational Reporting Level	State Secretary Officer	Chief Executive Officer	Audit Committee
Administrative Reporting Level	State Secretary Officer	Head of Department	Chief Executive Officer
Internal Audit	Department	Division	Unit
Establishment	2001	2010	2003
Portfolio	Solely internal audit	Internal audit, integrity unit and investment unit	Internal audit, integrity and risk management
Internal Audit Staff	5	2	8
Average Years of Experience	3 to less than 6 years	6 to less than 9 years	9 to less than 12 years
Existence of Audit Committee	Yes	No	Yes

From the analysis of internal audit capability matrix using the questionnaire answered by the heads of internal auditor in CSA, CSB and CSC, it is found that internal audit unit in CSA and CSC both obtained capability level 2 (infrastructure) while CSB only achieved capability level 1. CSA scored the highest KPA percentage which are 82% followed by CSC (76%) and CSB (71%). Table 2 shows the summary of IACM analysis for all case studies while Figure 4 shows the cobweb mapping of scored elements.

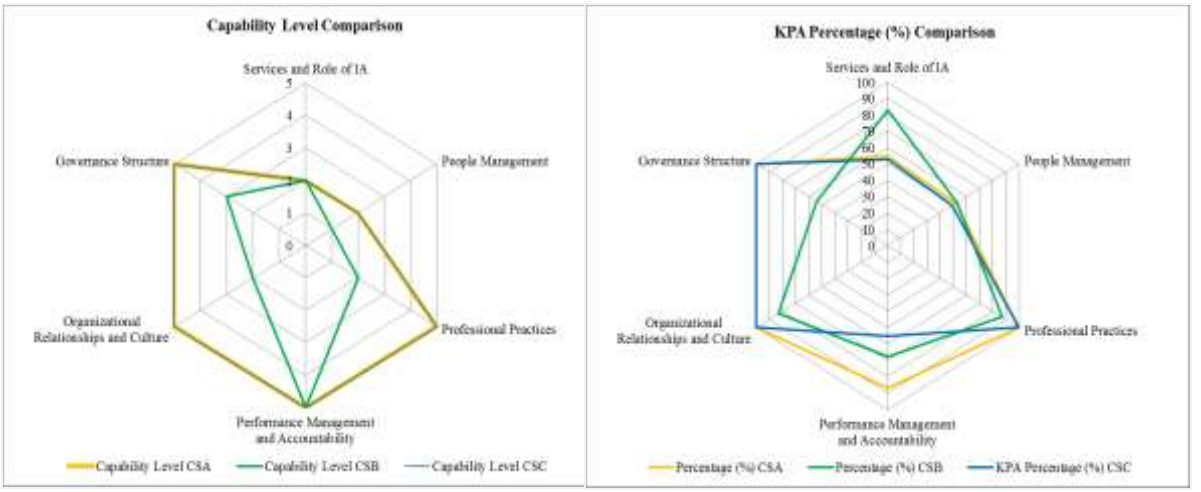
Table 2: Summary of IACM Analysis

Dimensions	Capability Level			KPA Percentage (%)		
	CSA	CSB	CSC	CSA	CSB	CSC
Services and Role of IA	2	2	2	55 %	83 %	53 %
People Management	2	1	2	52 %	53 %	49 %
Professional Practices	5	2	5	100 %	87 %	100 %
Performance Management and Accountability	5	5	5	87 %	68 %	55 %

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Organizational Relationships and Culture	5	2	5	100 %	83 %	100 %
Governance Structure	5	3	5	100 %	54 %	100 %
Overall Capability Level & KPA Percentage	2	1	2	82 %	71 %	76 %

Figure 4: Cobweb Comparison of IACM Dimensions



CSA shows that it achieves level 5 (optimized) for all four dimensions of professional practices, performance management and accountability, organizational relationships and culture as well as governance structure. However, it only achieves level 2 (infrastructure) for both dimensions of services and role of internal audit and people management. CSB only achieves level 5 (optimized) for dimension of performance management and accountability. For dimension of governance structure, CSB achieves level 3 (integrated). Other three dimensions of services and role of internal audit, professional practices and organizational relationships and culture achieves level 2 (infrastructure). CSB scores poorly for people management dimension which is only level 1 (initial) which resulting the overall capability of only level 1 (initial). CSC shows that it also 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.

Even though CSA and CSC scored the same capability level of each dimensions, but, the KPA percentages obtained by each dimensions are different. CSA and CSC both scored 100% for three dimensions that are professional practices, organizational relationships and culture and givernance structure while CSB did not score 100% for any dimensions. But, it obtained the highest KPA percentage score of 83% for services and role of internal audit dimension compared to CSA and CSB which only score 55% and 53% respectively. As for people management dimension, CSB also scored slightly highest compared to CSB and CSC scored the lowest which is less than 50%. For performance management and accountability dimension, CSA scored the highest KPA percentage with 87% followed by CSB (68%)

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and CSC only 55%. CSB only scored 83% for organizational relationships and culture compared to CSA and CSC which both scored 100%. It also scored lowest KPA percentage for governance structure i.e. 54% compared to maximum scored obtained by two other organization.

Achieving capability level 2 (infrastructure) of services and role of internal audit dimension by all organizations studied in this research indicates that all cases merely reviews compliance with policies, contracts and legislation. This shows that all three cases have the proper documentation of internal audit charter, perform audit engagement and communicate the results of the audit engagement. They also provide these audit reports to the appropriate parties (including external auditor, where relevant) and carry out management action plan if necessary (Institute of Internal Auditors Research Foundation, 2009). To advance from level 2 to level 3 (integrated), the units should practice advisory services and conduct performance/value-for-money audits. Achieving capability level 3 means that the audit function generally conforms to the International Audit Standard.

While for people management dimension, achieving level 2 shows that the IAF employs skilled internal auditors and practices individual professional development. It shows that CSA and CSC are ensuring that a continuous maintenance and enhancements of its internal auditor's professional capabilities are on track. The IA function also manages to identify and recruit staff with necessary competencies and relevant skills to carry out IA duties which will likely to provide credibility to internal audit results. At the initial level 1 as obtained by CSB shows that the internal auditing is characterized by unstructured processes i.e. it relies on the skills and abilities of specific individuals where few processes are defined and practices are performed inconsistently. Auditing is likely limited to transaction auditing i.e. examining the regularity and accuracy of individual economic transactions, or some basic compliance auditing. The infrastructure for IA activity has not been fully established and auditors are likely part of a larger organizational unit where funding is approved by management as needed. At this level, PSB faces the risk of not being able to rely on or routinely benefit from the value-added contribution of internal auditing. To move from level 1 to level 2, CBB should establish and maintain repeatability of processes (Institute of Internal Auditors Research Foundation, 2009).

On the highest capability level of professional practices as scored by CSA and CSC 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. The IA activity has achieved organization-wide respect for demonstrating value in anticipating the organization's needs and contributing to the achievement of strategic and organizational objectives. It requires that the IAF continuously endeavors to improve its professional practices in such a way as to develop its capacity. 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. At this level, the IA department has also managed to facilitate the performance of audit engagement with independence and objectivity without much challenge. Audit engagements are performed with proficiency and due care. Visible commitment and action by senior management through supporting the professional nature of internal auditing and providing appropriate resources to create professional practices and processes framework are institutionalized in the organization (Institute of Internal Auditors Research Foundation, 2009).

All cases studied scored the highest capability level 5 for this dimension. It 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. In other word, these units report publicly

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on the effectiveness of the IA activity to demonstrate transparency and accountability to the organization's stakeholders and the public, and identify the contribution and impact made by the IA activity with the resources provided. External stakeholders have timely and relevant performance information to make appropriate decisions and the citizens are engaged, thus, the public obtain clearer understanding of the distinct and different roles that internal auditing and management have in meeting the objectives of respective organizations (Institute of Internal Auditors Research Foundation, 2009).

On the other hand, the highest capability level scored by CSA and CSC 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. IA unit is proactively communicate key strategic and operational issues to management and other stakeholders and make recommendations. They maintain and foster the mutually respectful relationship with the organization's external auditor and thus, IA activity is seen as a credible business partner throughout the organization. For CSB which scores capability level 2 of this dimension, it indicates that the CSB participates in the organization's management activities in some form as a valued member of the management team. Although they do not carry out management's responsibilities, he or she is included in communications and forums of the management team, and as an observer, is able to maintain a channel of communication with senior management. In other word, he or she is seen as integral (fundamental) to the organization's management team and contribute to achieving organizational results (Institute of Internal Auditors Research Foundation, 2009).

CSA and CSC 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 only scores level 3 which implies that for this dimension, CSB at least meet the International Auditing Standard and have full access to the organization's data, assets and people with established reporting structure. It shows that CSB has established formal reporting relationships both administratively and functionally (Institute of Internal Auditors Research Foundation, 2009).

The result obtained might be due to the nature of the organizations. CSA is a state level organization which has been established since 2001 compared to CSB, a statutory body organization which has only been established in 2010. While CSC, a public university which is also represents a federal state statutory body has been established in 2003. The requirement of establishment of internal audit unit in federal and state level is stricter according to Treasury Circular PS 3.1 and PS 3.2 2013. On top of that, CSB has not yet officially endorsed the Audit Committee which would result the difference in the achievement of higher capability level and overall KPA percentage.

Besides that, International Professional Practices Framework (IPPF) Standard 1130 has also stated that internal auditor should refrain from accepting responsibility for non-audit, operational functions or duties; as happened in CSB and CSC where their internal audit division has also carried out other functions which of integrity unit and moreover CSB also acts as part of investment unit management for its organization. Acceptance of such responsibilities can impair independence and objectivity (Institute of Internal Auditors Malaysia, 2008). 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

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primary responsibility is detecting and investigating fraud. Internal auditors should examine and evaluate the adequacy and effectiveness of their internal control's system. This is because internal control is the principal mechanism for preventing fraud (Institute of Internal Auditors Malaysia, 2008). 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 (Institute of Internal Auditors Malaysia, 2008), especially with management accountant of the organizations.

Other factor that may cause such result is related to the professional qualification and membership. Since the IACM is developed by the Institute of Internal Auditors, the requirement of being the IIA membership is one of the elements in Key Process Areas (KPAs) of people management dimension. Neither head nor staffs of internal audit CSB have such membership which impacts the capability level of this dimension compared to CSA and CSC where both of the internal audit heads are IIA members. However, head of internal audit CSB was able to carry out her task well with the qualification of ACCA and assistance from the head of internal audit CSA at the earlier stage of setting up the internal audit department.

According to Standard 2030 IPPF related to resource management – the 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, 2008). Nevertheless, these three organizations studies have lack of human resource which may impede their performance of audit services and scored lowest on the people management division. This is one of the reason for ineffective internal audit unit of Malaysian public sector organizations as reported in previous research conducted in Malaysian public sector organizations (Ahmad, Othman, & Othman, 2010; Ahmad et al., 2009; A. M. Ali et al., 2009, 2012, 2007; A. M. Ali, Saad, Khalid, Sulaiman, & Gloeck, 2011). According to the interview conducted, the issue of staffing might happen due to the policy where it is clearly stated that all internal auditor warrant or appointment in all government entities should only be authorized by National Audit Department (NAD). Thus, the utilization of manpower is restricted based on the availability of staff from NAD.

3. Conclusion

The critical role of Internal Auditors in the public sector has been amplified by various parties today (Fern, 2015). Recognizing this, the Institute of Internal Auditors Research Foundation (2009) develops a set of criteria, the Internal Audit Capability Model to assist appropriate and systematic development of the internal audit function in public sector. A mature and competent IA function will be able to assist the organization in achieving its objectives economically, efficiently and effectively. The IA activity is expected to work collaboratively with the organization's management and the oversight body to provide optimum assurance that its governance processes are efficient and effective, while the internal controls are also sufficient to mitigate identified risks, and organizational objectives and goals are met (Institute of Internal Auditors Research Foundation, 2009). As the IACM uses the building-block methodology, the IA unit can easily analyze and choose the weak KPAs to focus in order to proceed to the next capability level.

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In this study, both CSA and CSC scored overall capability level 2 and thus to advance to higher capability level, they should emphasize on the KPAs required for level 3 especially for two dimensions of IACM that are services and role of internal auditing. Such KPAs are including providing advisory practices and performance/value-for-money auditing. This recommendation also applies to CSB which scored same level. Another lacking dimension is people management. It is recommended that all IA units in these three cases should enhance this dimension by coordinating the development of periodic audit and services plan to the human resources levels authorized to IA activity. IA activity needs to used appropriate methods to set priorities on planned projects and services to limit its commitments to a doable quantity and type of project and services since the resources are often constrained. IA unit should also be staffed with professionally qualified staff and retain individuals who have demonstrated a minimum level of competence. Besides that, focus on individual project team should be done to develop staff member's capacity to function effectively in a team environment. Commonly, many public sector audits cover scopes that require the concerted effort of a team auditors to conduct, thus, additional team competencies are required (Institute of Internal Auditors Research Foundation, 2009). Specifically for CSB, it is highly recommended that the head of internal audit should obtain IIA membership as complimentary to the professional certificates they had. On top of that, the most crucial step that CSB should take is to obtain the endorsement for Audit Committee which has yet to be done at the time of research.

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). The performance measurement of CSA, CSB and CSC is not available, thus, the IACM evaluation result is not able to have a benchmark comparison. Apart from this, this research study only confined to limited government agencies samples (one state level, one state statutory body and one federal statutory body) at East Coast Region of Peninsular Malaysia. Further exploration is required in order to have a bigger picture of internal audit units in Malaysian public sector organizations from the IACM context and gaps existing to deploy this matrix across the nation. Therefore, the IACM evaluation research should bring to different ministries, departments, statutory bodies, local authorities, and government linked companies. A quantitative approach may be used to expand the samples of research. Thus, the result might be generalized to all Malaysian public sector organizations.

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