

Internal audit in the state and local governments of Malaysia

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ABSTRACT

Internal audit is supposed to help members of organizations to improve their entity's effectiveness and efficiency. But the findings from in-depth interviews conducted with internal auditors from 35 State and Local Governmental Bodies (SLoGBs) located in Peninsular Malaysia in the third quarter of 2003 show that the audit function faces numerous challenges. This is in addition to the fact that a mere 35 out of the then 202 SLoGBs had an internal audit capacity.

The politics of accountability theory, power distance, and a Malaysian social context that is replete with cases that display a lack of transparency and public accountability from its major actors, help to explain these facts and predict a bleak future for internal audit.

However, a rosy future may yet be achieved through the involvement of key parties and if specific measures are put in place. This is the crucial role that the federal government in particular should play so that the audit function may fulfill its potential as a tool that improves Malaysia's economic standing at this time when globalization, accountability and transparency are considered essential issues in just about any worthwhile economic, social or political activity.

Key words

Internal audit, state governments, local governments, federal government, Malaysia, National Audit Department, qualitative methods, in-depth interviews, Institute of Internal Auditor, social context, accountability

1 INTRODUCTION

In recent years, entities in both the public and private sectors have experienced many new challenges and demands resulting from the combination of a harsh economic climate and rapid developments in technology, market conditions and globalization. To ensure the survival of these organizations, internal auditing has increasingly been viewed by regulators, directors of listed companies and governing members of many public sector entities world-wide as one of the solutions. Specifically, the need for strong 'corporate governance' in the management of corporations and public sector enterprises has focussed attention on the internal audit function. Good corporate governance demands sound financial and operational control over the activities of an entity.

For an effective system of internal controls to exist a well-managed internal audit department or unit is required, whose activities are strongly supported by both management and other personnel within the organization.

The development of modern internal auditing begins with the formation of the Institute of Internal Auditors (IIA) in the USA in 1941. Shortly thereafter IIA chapters were established across the USA and worldwide. Internal audit is now widely seen as a highly professional and skilled task. The original definition of internal auditing provided by the IIA in its Standards for the Professional Practice of Internal Auditing (SPPIA) in 1978 states (IIA, 1979):

Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed.

In a more recent definition, included in the SPPIA which came into effect on 1 January 2002, the body provides a broader goal for internal auditing. This new definition shifts the focus from one of assurance to that of value added, and attempts to move the profession toward a standards-driven approach with a heightened profile (Nagy & Cenker, 2002; Bou-Raad, 2000; and Krogstad *et al.*, 1999). The subsequent definition says (IIA, 2003):

Internal auditing is an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control and governance process.

For over half a century now the IIA has also published standards and a code of ethics for the practice of internal auditing. Today, these standards and code are in use in thousands of organizations in more than 100 countries, and across all business types and public sectors (Ridley & Chambers, 1998, pp. xxix-xxx). This is not surprising, since the internal audit standards in particular, also include inputs from outside the United States. As mentioned in the "Introduction" to the SPPIA (IIA, 2003a):

The Internal Auditing Standards Board is committed to extensive consultation in the preparation of the *Standards*. Prior to issuing any document, the Standards Board issues exposure drafts internationally for public comment. The Standards Board also seeks those with special expertise or interests for consultation where necessary.

Indeed, all who practise internal auditing are expected to understand the standards and code of ethics, and to adopt or modify them to suit their own environments. Over the years, these documents have been enriched by research and successive interpretive guidelines and statements, detailing how professional internal auditing should be practised. Unfortunately, as noted by Ridley & Chambers (1998, p. 3), many organizations have failed to bring significant change to their internal auditing practices. They state (p. 3): "True, there are now more internal audit units; yet most of their practices are still based on fundamental auditing principles, as developed in the early years of the twentieth century." They also specifically note that (p. 3): "Despite a 1990s focus on rapid change within many organizations, in some internal audit units technology has still not penetrated deeply into auditing practices, while in others internal

auditors are still not seen as part of the management team."

In Malaysia, a growing catalogue of organizational failures and mismanagement highlights the need for effective internal audit in both the public and private sectors. While to date there have been several research reports on the status of internal audit in general (see below), none have specifically probed the nation's public sector. This is despite the well documented requirement that management of public sector organizations should maintain an effective system of internal control, including the establishment of an internal audit function (Dowsett & Morris, 1981; Buttery, 1985; Coombs & Jenkins, 1994; Jones & Pendlebury, 2000). And this lack of progress in establishing an internal audit function is in spite of the requirement having been published nearly a quarter of a century ago in Treasury Circular No. 2 (1979) entitled Implementation of Internal Auditing in Federal Government Agencies.

Apparently this Circular was supposed to have been replaced in April 2001 by one that covered not just the federal government but also the state and local governments, and which was to have provided greater detail of the required functions of the internal audit units so formed. It is not known why this document was not implemented by the authorities at that time. Eventually, in October 2004 – one year after this study's data had been collected, and while this report was being finalized - the Federal Government, through its Director General of the Treasury, issued circular No. 9 (2004) to replace the 1979 circular. (*New Straits Times*: 18 December 2004).

This new circular not only applies to federal government's departments, but also to the state governments. It is noticeable that the new circular (which may be found in the Treasury website – <http://www.treasury.gov.com>) has nearly twice as many paragraphs as the 1979 one. There are also some paragraphs (discussed below) which suggest that the authorities are pushing to improve the public sector practice of internal audit. However, the reality of their implementation may be something different. (Malaysian life abounds with cases of "the triumph of hope over experience".) See for example Azham (1999) on the external audit perspective on the 1985-86 economic recession and its aftermath.

Regardless of the release of the 2004 Circular, it should have been obvious that the state of internal audit operations in the public sector was long overdue for review. This review should have led to the identification of problems and obstacles confronting internal audit, and recommended real reforms, reforms far more rigorous than the mere issuance of a document such as that required by the new internal audit circular.

Furthermore, such a study is needed to assist the nation to find ways to be more competitive in all sectors of the economy, made more urgent by the implementation of Asean Free Trade Area (AFTA) in early 2003. Internal audit that achieves its potential

may actually be the right instrument for all sectors to achieve such competitiveness. Finally, the East Asian financial crisis in 1997/1998 proved that all strata of society have to be more serious about implementing good governance. Mere lip service or rhetoric is worth little in today's socio-economic environment. Today's challenge is not just for companies, but also for public sector entities to acknowledge the need for, and to implement good governance.

2 PURPOSES OF STUDY

The primary objective of this study is to compile a data base of the forms and extent of internal audit being practiced in government entities operating throughout Peninsular Malaysia. These entities include state and local government departments and their various statutory bodies. The focus is on the day-to-day problems faced by the internal auditors. A further objective of the study is to try to provide an explanation for the present state of affairs. Finally, the study attempts to predict the future of internal audit in government enterprises and departments. All in all, the study has three basic aims related to answering the following questions:

- What kind of internal auditing is being practiced?
- Why is there this type of internal auditing?
- What is the likely future of internal audit?

3 MOTIVATION AND SIGNIFICANCE OF THE STUDY

There does not yet appear to have been any attempt to provide an overview of the internal audit function in the Malaysian public sector. In regard to the state and local governments and related bodies in Peninsular Malaysia this study is probably the first to have been conducted. The availability of such information should greatly assist policy makers and other parties to determine what exactly needs to be done to improve the internal audit function. This is in line with the Prime Minister's goal of reforming Malaysia.

The Prime Minister mentioned in a speech in early 2004 that his agenda for the country included the creation of a more efficient public administration, the eradication of corruption and the cutting of red tape (*NST*, 12 February 2004). It should be obvious that the achievement of such an agenda needs up-to-date information on all aspects of the economy. The concerns of the internal auditors appear to be of particular importance since their position within government departments should help the authorities understand the day-to-day processes. But they have never enjoyed public recognition, in contrast to external auditors working for the National Audit Department. Actually the Prime Minister himself sees the need for auditors (presumably also including those outside the National Audit Department) to be effective in their work. In his maiden official speech in Parliament, the Prime Minister said (*NST*, 4 November 2003):

Corruption is an odious crime. We must explore more effective methods to deal with it and in this regard, prevention is as important as punishment.

Streamlining work processes, reduction of red tape, improvements in the delivery system, a conscious effort to raise the quality of work and *more frequent and effective audits* would reduce the opportunity for bribery. (Emphasis added.)

In addition, this study is particularly significant since the nation's Auditor-General, who is the head of the National Audit Department, has stated in various audit reports that inefficiency in the administration of most state governments and local authorities in the country has resulted in severe weakness in their management of revenues and expenditures. Recent revelation by *New Straits Times (NST)* (26 September 2002) regarding possible misappropriation of assets in a Malacca state government agency is a case in point (and which incidentally shows the crucial role played by internal auditors in uncovering fraud):

Malacca state government has detected assets amounting to RM21 million missing from its agency, Yayasan Melaka dating back to 1996. However, RM8 million has been recovered by the internal auditors appointed by Chief Minister and were working hard to detect the remaining RM13 million worth of assets.

Another motivation for this study concerns the increasing internationalization of internal auditing that began in the 1990s (Foster and Greenawalt, 1995; Chambers, 1996; and Miller, 1999). As a result of this, the Institute of Internal Auditors (IIA) 1997 Global Forum identified a worldwide need to have a greater understanding of internal auditing (Lower, 1997). The promotion of internal auditing around the world is presently a priority of the IIA Global Steering Committee (IIA, 1999). This study may thus also be viewed as an effort to assist interested parties outside Malaysia in understanding the nature of internal audit within a section of this nation's public sector. Perhaps through that understanding these parties can in turn assist Malaysians to achieve the successful operation of their internal audit function.

With all these objectives for the study, the following significant outcomes are desired:

- To facilitate a better understanding of the main issues affecting internal audit practice in the Malaysian public sector in the state and local governments in Peninsular Malaysia. Through their identification, the nation's policy makers may be assisted in their efforts to improve the internal audit function throughout the government sector.
- To stimulate other research into internal audit. It is hoped that this study's conclusions will be tested and extended by other academics, focusing on related sectors such as the Malaysian federal government, co-operatives, NGOs and perhaps even the corporate sector, with particular reference to development issues in Malaysia and other developing countries; and
- To identify consultancy, training and development programs needed by internal audit units in the government entities studied.

It is the authors' belief that, despite the accepted negative view of internal audit, change and reform are possible.

4 LITERATURE REVIEW

The practice of internal audit has a long history, but its goals have changed over time. Grier (1934, p. 4) notes that the Zenon-papyri record that internal audits were conducted on the Egyptian estate of the Greek ruler Ptolemy Philadelphus II approximately 2,500 years ago. According to Flesher and Zarzeski (2002, p. 94), these early audits were in many ways similar in scope to that of the modern (post World War II) internal audit in that they included both an examination of the correctness of accounting records and an evaluation of the propriety of activities reflected in the accounts. In short, the objective was on improving management control over the activities of the organization. This contrasts with the situation during the latter part of the 19th century and the first half of the 20th century where the emphasis was on the detection of fraud. In explaining the turning point from traditional (fraud detection) to modern (business management enhancement) auditing, Flesher and Zarzeski (2002, p. 95) state that the war economy in the early 1940s played a part whereby the internal auditors "... started directing their efforts towards assisting management in any way possible." And following World War II, the benefit of the auditor's assistance was so obvious to management that there was no consideration of reducing the auditor's scope to pre-war levels.

In public sector organizations, the internal audit function appears to hold high potential for promoting accountability and improving government performance. Not surprisingly, several countries have developed policies that strengthen the public sector internal audit function and enhance their capacity for contributing to these goals (Auditor-General of Australia, 1990; Office of the Auditor General of Canada, 1993 and 1996; Light, 1993; Newcomer, 1994 and 1998). Policy measures include the following: requiring the establishment of internal audit units; establishment of standards for the professional conduct of audit work; training; resource allocation; expanding reporting arrangements and broadening mandates to make auditors responsible for performance assessment. Also, the understanding that internal auditing is an important tool for accountability has led, in the case of the United States, to the internal audit functions being transferred to Inspectors-General who report findings to both the Executive and to Congress. Thus, internal audit is now also a tool for external accountability and no longer merely a tool of internal accountability intended to aid senior management of the government organizations.

Nonetheless, available evidence on the recent reality of internal audit operations suggests that there is much room for improvement. In the United States, Canada and Australia, the following are the common findings: inadequate audit coverage, particularly of areas of major significance and high risk; a tendency to focus audits on compliance and regulation, to the

detriment or exclusion of audits of economy, efficiency and effectiveness; and little attention to audit findings within agencies by senior managers. Furthermore, in Canada and Australia, professional qualifications of audit staff are inadequate and there is insufficient involvement of senior management in audit planning. As for the United States, based upon his study of the work of the nation's Inspectors-General, Light (1993, p. 224) concludes that "government appears no more accountable today than before the IG Act."

4.1 Developing nation's examples

As perhaps can be expected, the distance between internal audit ideals and their realities is not unique to these three developed western countries. In the Sudan the situation is far worse. As noted by Brierley *et al.* (2001, pp. 73-4), the typical internal audit department in the Sudan is engaged in largely routine authorisation of transactions, is staffed by inexperienced and untrained personnel, and has insufficient credibility, independence or authority to act in the manner expected of internal auditors. Employing interview and observation research methods, they conclude that in the few places where internal audit may be in operation, it has failed to meet even one of the five core standards of the IIA in terms of independence, professional proficiency, scope of work, performance and management. To explain this depressing picture of internal audit in the Sudan's public sector, the authors consider the context within which the internal audit process functions. These factors include the country's poor economy, political instability and institutionalised corruption. They predict that in such an environment, and without the political will to make the necessary correction, internal audit in the Sudanese public sector "... will continue to be marginalized in the foreseeable future."

In another developing country the picture of internal audit in the public sector is also not that rosy. As noted by Schwartz and Sulitzeanu-Kenan (2002), in Israel the recent efforts to strengthen internal auditing through a top-down legislative solution "... have not significantly improved the overall performance of audit units in the lion's share of ministries and statutory authorities." Specifically, the 1992 Internal Audit Law places a statutory duty to perform internal audits in every public entity; requires professional training; requires access to information; grants a broad mandate that includes audits of economy, efficiency, effectiveness and decision-making, and makes auditors directly responsible to either the Director-General or the Minister. In addition, a 1995 amendment requires that senior management discuss audit findings within 45 days of submission. However, Schwartz and Sulitzeanu-Kenan (2002) claim that the Law has neglected a number of provisions which would have improved the effectiveness of the internal audit function. From a review of the literature, they identify three structural variables: audit coverage capacity (audit staff to total staff, and audit budget to total budget ratios); professional expertise; and organizational status. They also identify the absence of a central body for training and advising public

sector internal auditors and for monitoring their work as a serious omission in the Law. (They point out that this training and advisory body is in operation in the UK and Canada.) Overall, they stress that most stipulations of the Law do "little more than to upgrade existing rules to the statutory level".

After employing a variety of research methods including in-depth interviews with 25 internal audit units of government ministries and statutory authorities, Schwartz and Sulitzeanu-Kenan (2002) conclude that Israeli internal audit units operate "well below reasonable capacity and accepted practices." In reaching this conclusion on the effects of the Internal Audit Law on internal audit practice the authors assessed structure (mentioned earlier); process (involving eight variables related to involvement of senior management; audit scope; and treatment of audit findings); and outcome (three types based upon the perception of internal auditors contacted). They utilise the "politics of accountability" and "policy change" theories to explain the causes of ineffectual internal audit legislation and of its related weak implementation.

4.2 Malaysia

In Malaysia very little is known of the state of internal audit in the public sector. The same may also be said for internal audit in the private sector. To date very little research appears to have been conducted.

The Malaysian Institute of Accountants (MIA) was established in 1967 (with the promulgation of the Accountants Act 1967). However it remained inactive and its first annual general meeting was only held in 1987 (Azham, 1999). The Institute appears to have conducted its first research project in June 1988 – less than a year after the statutory body was "activated" in September 1987 (MIA, 1989). The study involved sending questionnaires to the heads of internal audit of 658 organizations in both private and government sectors, including all companies then listed on the Kuala Lumpur Stock Exchange (KLSE) (now the Bursa Malaysia). The response rate was 37 percent or 241 organizations. The study's results formed the MIA's Report No. 1 issued in July 1989.

Report No. 1 showed that 129 organizations (56 percent of the responding organizations) had no internal audit departments. And out of these 129 organizations, 46 mentioned that the internal audit was carried out by the holding company or "government auditors". The report also investigated the head of internal audit's reporting structures as they affected the audit report, his required qualifications and his audit responsibilities. It is worth noting that this report received only ten responses from government organizations (recorded as "Government/Statutory" (see Report No. 1, Table B, p. 3)), and that five had no internal audit departments.

In August 1989 the MIA conducted a second study which they claimed was more in-depth than the earlier one (MIA, 1991). Two sets of questionnaires were sent out, one to internal audit managers and another to chief executives. There were 106 responses

(19 percent) from the internal audit managers and 133 (24 percent) from the chief executives. Report No. 2 states that these questionnaires were sent to 555 organizations covering both listed and unlisted companies, statutory authorities and government departments. In contrast to Report No. 1, it does not disclose how many government sector responses there were. The report also glosses over the various and serious issues uncovered by the first study, including the areas of responsibility and reach of the internal auditors. The MIA's second report attempted to justify the distressed state of the internal audit function in Malaysia as a function of Malaysia's "emerging economy" status (p. 2), and that internal audit in Malaysia was similarly an "emerging profession" (p. 10).

Besides these two MIA studies conducted in the late 1980s, there appears to have been just two other studies conducted in the next decade. One was by a group of Australian academics (Mathews et al., 1995) on internal audit in both private and government organizations (and which was later used in a benchmarking study by Cooper et al., 1996), and another, in late 1999, which was a collaboration between the audit firm Ernst & Young, the Malaysian Institute of Corporate Governance (MICG) and the Institute of Internal Auditors Malaysia (IIAM) (Ernst & Young et al., 2000). The focus was on internal audit in companies listed at the KLSE (now Bursa Malaysia) and the Malaysian Exchange of Securities Dealing & Automated Quotation Bhd. (MESDAQ). While the MIA studies were concerned with an "overview" of internal audit, the next two focused on the nation's internal audit "profile". But just as in the MIA studies, the latter two studies also failed to provide much detail on the operation of internal audit in Malaysia. This is particularly disheartening considering that Ernst & Young, in its study of internal audit in Russia and the Commonwealth of Independent States (the CIS) (Ernst & Young, 2002a) and another one in the Caribbean (Ernst & Young, 2002b), produced considerable amounts of interesting data. Its failure to do the same on the state of internal audit in Malaysia is a little mystifying.

The lack of research into internal audit has provided limited insight and given little guidance in respect of internal audit. Therefore, government departments really only have the internal audit circular, issued as far back as 1979 by the Treasury in the Finance Ministry, for guidance.

This circular defines the role and responsibilities of the internal auditor. But it clearly lacks detailed standards for the qualification and necessary due diligence processes and procedures expected for internal auditors. Thus, as noted by Chang and Davidson (1999, p. 29) when discussing "Audit Law" in the People's Republic of China and which is equally applicable to Malaysia, training and education needs are hard to define and justify without the presence of clear standards (in the form of an internal audit circular). Also, without a definition of professional standards in the circular, performance evaluation, quality assessment and assurance are very difficult to achieve.

All in all, it is true to say that the major questions concerning the public sector's internal audit capacity and its operations have remained unanswered. This is obviously not conducive to any serious efforts to ready the country to face the challenges of globalisation. This study attempts to shine the light of understanding into that "black hole" and maybe, as far as internal audit is concerned, Malaysia could set an example for other developing nations.

There are numerous models for this type of study besides those used in the Sudanese and Israeli studies mentioned above. An internet search led to two notable recent studies, conducted in Canada (Canadian Treasury Board Secretariat, 2000) and Malta (National Audit Office, 2000).

The Canadian study was conducted in 2000 by the Treasury Board Secretariat – the central agency responsible for the internal audit function in the federal government. This was in response to many years of criticism of the state of internal audit in Federal government departments from both inside and outside parliament. The stated purpose of the study was: "...to further analyse the issues raised by these observers regarding internal audit in the government and to propose an appropriate course of action." The Secretariat consulted with both private and public sector representatives, including several deputy ministers and assistant deputy ministers. They also reviewed submissions and official documents produced by interested local and overseas parties, including the Institute of Internal Auditors, based in the United States, and the Australian National Audit Office.

In their report, the Secretariat detailed the various steps that needed to be taken in order to strengthen the internal audit operations. A notable one was the need to review the federal government's internal audit standards.

In the "Executive Summary" the Secretariat states: "Our assessment of the existing standards against suitable benchmarks indicates that the present standards are deficient in a number of respects... Improvements in these and other areas are needed to better align the government standards for internal audit with those of recognised auditing bodies." This candid admission of deficiency, together with the recommendations contained in the report, have had the unintended effect of encouraging other researchers elsewhere in the world to work on improving the internal audit operations in their countries' public sectors.

The Maltese study focussed on internal audit in government ministries and departments and took place between January 1998 and July 1999. It was conducted by the National Audit Office (NAO) of Malta with assistance from an outside consultancy firm. The aims of the study were to evaluate the internal audit function and to make recommendations as to its future role. Data was gathered mainly through questionnaires mailed to all eleven internal auditors: nine responded. Later in July 1999, interviews were also conducted with a number of

government officials, including seven internal auditors. The NAO also analysed "relevant documentation".

Key issues studied included the administration of the function by a central body; the independence of management support; the level of management support, and the resources provided for and restrictions on the function. Various distressing problems were uncovered and many specific improvements were proposed. With its concise, no-nonsense manner of presenting the problems and the recommended improvements, this research study has, in common with the Canadian one, an abundance of information of international applicability to the process of enhancing the effectiveness of the internal audit function.

5 RESEARCH DESIGN

5.1 Population and survey sample

The Malaysian government hierarchy has three levels: federal, state and local. Local governments include the city, town and local councils, depending on the territory's population. The federal constitution stipulates that local governments, outside the federal territories of Kuala Lumpur, Labuan and Putrajaya, are under the exclusive jurisdiction of their respective state governments. Thus, the state governments have wide legislative powers to control local governments and to ensure their proper functioning.

The population for this study comprised the organizations forming the state and local governments and the state statutory bodies in Peninsular Malaysia (as of May 2003). Specifically, these are:

- 11 state governments;
- 93 statutory bodies for state governments; and
- 98 local governments.

Initial investigations found that a mere 33 out of a total of 202 qualifying entities possessed internal audit departments or units. A further two were found after the field work had been completed and were also included in the survey sample. A further 52 organizations responded to the research project. None of them had an internal audit department or unit.

Since these 52 organizations were not selected through random sampling, it cannot be assumed that the results are representative of those organizations not contacted by phone. The authors do suggest, however, that the results could be applicable to all organizations without internal audit service, provided that their organizational and operational circumstances are similar to those organizations whose personnel were interviewed.

5.2 Methods of data collection

The main form of data collection was through face-to-face and telephone interviews. But, documents such as newspaper reports and audit reports issued by the

National Audit Department were also reviewed. Finally, during the face-to-face interviews, basic observation of the interviewees was done. In other words, the body language of the interviewees was recorded and used to enhance the understanding of the verbal responses. Despite gathering this data it was not the intention to turn this into an ethnographic or sociological study. However, the researchers were aware of a high level of animation (expressive body language) accompanying the verbal responses, and this was used to add "colour" to the purely verbal responses to the questions. During the face-to-face interviews the interviewer also took conscious note of the internal audit department's office facilities and resources (presence of filing cabinets, photocopying facilities, word-processing facilities, etc.).

The literature refers to these efforts as qualitative methods of collecting data (Van Maanen, 1979, p. 520). These approaches to data collection were intended to enable the researchers to apply triangulation to reduce systematic bias in the research work (Patton; 1990, p. 470; Miles and Huberman, 1994, p. 266). It is interesting that Neuman (1991, pp. 329-30) has suggested that triangulation not only increases the "sophisticated rigor" of the data collection and analysis process, but also helps disclose the "richness" of social settings for a qualitative inquiry. He mentions that quantitative researchers would consider the inconsistent picture derived from data on the same social event and collected by different methods, different researchers or at different times, as "bias" or "error". This he says would not be the case for a qualitative researcher.

5.2.1 *In-depth interviews*

The main bulk of the data was derived from face-to-face and telephone interviews. The face-to-face interviews were conducted with the internal auditors working in government internal audit departments or units, while the phone interviews took place with concerned parties in organizations that did not have an internal audit function. Only after the completion of the face-to-face interviews was it discovered that two other organizations in fact did have internal audit departments. For logistical reasons phone interviews were conducted with members of these two organizations.

The interview questionnaire for the internal auditors focussed on the following key issues:

- The role, scope and perceived value of internal audit
- The types of activities internal auditors perform
- The size, structure and authority of the internal audit function
- The independence of the internal auditors
- The resources allocated to internal audit
- The internal audit education, training, skills and expertise
- The government organization's attitude to internal audit
- The support mechanism for the internal audit function

- The interrelationship between internal and external auditors
- The present and future challenges and potential for change

There were four parts to the questionnaire: (A) Background information; (B) Organizational Audit Practice; (C) Supportive Efforts for Organizational Audit Practice; and (D) Internal Audit in the Organization and Government Sector as a Whole. Of a total of 60 questions, 51 were of a closed-ended, structured type (Parts B and C) and 9 were of an open-ended, semi-structured type (Part D). 12 of the closed-ended structured type questions had multiple sub-parts – (a), (b), etc. The development of the questionnaire is discussed in Appendix A.

The closed-ended structured type questions (Sections B and C) were concerned with the following: facts, such as the number of internal audit staff; perceptions, such as knowledge elements needed by internal auditors to ensure the fulfillment of their present roles; and the extent of agreement with various prepared statements. As for the open-ended semi-structured type of questions (Section D), there were three categories: the history and future of internal audit operation in the organization; present weaknesses and strength of the organization's internal audit department or unit; and obstacles to and potential for change in the operation of internal audit in the public sector as a whole.

Specifically with regard to Section D, the questions were designed to allow the interviewees a considerable degree of flexibility. The same applied to the questions raised in the phone interviews with the concerned parties in organizations which did not possess internal audit departments or units.

Thus, if an interviewee were to show great interest in an issue and wished to develop it further, he/she was encouraged to do so. If on the other hand, he/she was not comfortable responding, or claimed to have little knowledge of a particular issue, the question was dropped. This presented the possibility that more information could be collected from some people than from others. In general, the questions were prepared so as to ensure that all relevant topics were covered during the interviews. It was assumed that a common core of information would emerge from the interviews, but no standardized questions were prepared in advance. The wording and the sequence of questions were also adapted to accommodate specific participants in the actual interviews (Patton, 1990, p. 283; Kvale, 1996, Chapter Seven).

The questions were deliberately open-ended to enable interviewees to express their understanding in their own words. There were no predetermined phrases or categories from which the interviewee should choose. The intention was for the interviewees' viewpoints to be clearly understood by studying their terminology and opinions, and by recording the complexities of their individual perceptions and experiences. As Patton (1990, p. 278) succinctly notes, the purpose thus is to allow the interviewer to enter into the participants' perspective

using the assumption that the perspective of others is meaningful, knowable and able to be made explicit.

6 FINDINGS

All the face-to-face and phone interviews with the internal auditors took place during the third quarter of 2003 and the first quarter 2004. Out of the 202 SLoGBs in the whole of Peninsular Malaysia, it was discovered that a mere 35 had either internal audit departments or units (9 state governments, 14 local authorities and 12 state statutory bodies). (See Appendix B for the list of SLoGBs with internal audit and the auditors interviewed.) Of the 167 SLoGBs that had no internal audit department or unit, a total of 52 of them were contacted by phone in the first quarter of 2004. (See Appendix C for the list of SLoGBs contacted by phone.)

From this group of 52 SLoGBs that had no internal audit function, personnel from 48 of these provided useful data during the phone interviews. These 48 government bodies were situated in Perlis (4), Kedah (8), Penang (2) Selangor (5), Malacca (7), Negeri Sembilan (3), Pahang (8), Terengganu (4) and Kelantan (7). No phone calls were made to organizations in Perak and Johor because information at hand was that the internal audit function in these bodies was being carried out by internal auditors from the state governments.

Forty-five of the 48 organizations in this category considered internal audit to be an important tool for organizational improvement. Unfortunately, a meager 10 organizations said their organizations would be forming internal audit departments or units in the near future, while five others said that there was a chance

that the internal audit function might be outsourced instead. Two more organizations had just set up their internal audit functions. Among the 10 who said that their organizations would establish internal audit functions in the near future, two said that their organizations would opt for internal audit outsourcing.

A variety of reasons as to why their organizations had failed to form internal audit departments or units in the first place were presented. The more frequent reason was the small size of their operations.

From a total of 35 SLoGBs that possessed internal audit functions and that were interviewed (33 face-to-face; 2 by phone), it was found that they were experiencing a variety of problems in the audit operation. Some issues, such as audit staffing, audit charter and audit independence, occurred within an internal audit department or unit itself. These may be contrasted with those issues and problems involving interactions between audit personnel and other government personnel from outside the internal audit department or unit. These outside parties include the top management, departmental heads and non-audit personnel. These issues are discussed next.

6.1 Age of internal audit

Table 1 below shows that 16 SLoGBs (nearly 46 percent) have had internal audit capacity for no more than five years. In fact, nearly a quarter have had internal audit capacity for no more than three years. All in all, for just over half of the 35 SLoGBs possessing an internal audit function, the experience is still a relatively new one.

Table 1: Age of internal audit department or unit in the organization

	Total	%
Less than 1 year old	1	2.9
Over 1 year old but less than 3 year old	7	20.0
Over 3 year old but less than 5 year old	8	22.9
Over 5 year old but less than 10 year old	4	11.4
Over 10 year old	15	42.9
Total	35	100

At the other extreme 15 SLoGBs (over forty percent) have had an internal audit function for over ten years and this should at first glance be a positive factor. An in-depth look provides a more complicated picture. For at least one organization the internal audit function was apparently established in 1980 but was only in operation for the next two years. In early 2003, the internal audit function was reactivated, with a staff complement of two. Earlier, the internal audit activities were suspended due to the transfer of the audit personnel to other parts of the organization and its related bodies. But even with the recent reactivation, the audit head has still not been able to focus fully on internal audit because of being assigned by the organizational head to another, unrelated job. What made it worse is that both audit head and his assistant lack audit competence. In addition the audit programs that are supposed to be in place to provide

guidance are not available. It is therefore not surprising that what little audit they do conduct is related to the monitoring of "project management" – an area most familiar to the audit head.

6.2 Audit staffing

Within the 35 SLoGBs covered in this study, there are fifty eight diploma holders, thirty four first degree holders and seven masters degree holders working as internal auditors. (See Table 2 below.)

Also noteworthy is the fact that 14% of organisations have no diploma holders in their departments; 31% have no Bachelor degree holders, and 80% have no Masters degree holders.

Table 2: Total number of diploma, bachelor degree and master holders

Diploma			
No. of organisations	No. of diploma holders	Total no. of diploma holders	%
5	0	0	0.00
13	1	13	22.41
12	2	24	41.38
1	3	3	5.17
2	4	8	13.79
2	5	10	17.24
35	Total	58	100.00
Bachelors Degree			
No. of organisations	No. of bachelors degree holders	Total no. of bachelors degree holders	%
11	0	0	0.00
15	1	15	44.12
8	2	16	47.06
1	3	3	8.82
35	Total	34	100.00
Masters Degree			
No. of organisations	No. of masters degree holders	Total no. of masters degree holders	%
28	0	0	0
7	1	7	100.00
35	Total	7	100.00

In the closed-ended section of the interview, auditors from over two-third (or 24) of the SLoGBs voiced their dissatisfaction with the total number of staff working in their audit departments or units. The problem of inadequate numbers of audit personnel was also much stressed by auditors from the majority of the SLoGBs in the open-ended section of the interview session. In fact it was seen as one of their main

problems which is not surprising considering that out of the 35 SLoGBs, twenty of them (just over 57 percent) have a staff complement (including clerical) of no more than five. A mere 4 SLoGBs (just over 11 percent) have more than 11 audit personnel (see Table 3 below).

Table 3: Audit personnel available

	Total	%
Fewer than 3	5	14.29
Between 3 and 5	15	42.86
Between 6 and 10	11	31.43
Over 11 people	4	11.43
Total	35	100.00

The shortages in audit personnel as perceive by those interviewed is shown in Table 4 below.

Table 4: Audit staff inadequacy

	Total	%
Inadequate by 3 or less	13	54.17
Inadequate by 4 to 5	4	16.67
Inadequate by 6 to 10	5	20.83
Inadequate by over 11 staff	2	8.33
Total	24	100.00

In one particular organization whose audit operation has two staff members (compared with the organization's total of several hundred employees, and a budget of tens of millions of Ringgit), it resorts to the use of students from local institutions of higher education, who are undergoing practical training (as part of their degree program), to conduct internal audits!

In another case, the internal audit operation has fewer than five members but their audit responsibility is so extensive that they resort to seeking assistance from colleagues working in other departments within the organization. Problems arise when the assistance is needed for long periods, or when their departmental heads are reluctant to let them go.

6.3 Audit training and development

The open-ended part of the interview revealed that a lack of audit competency is one of the main problems faced by auditors in SLoGBs. In many cases, the heads of the internal audit operations themselves acknowledge that they do not possess full competence for their posts, and they must be saluted for their honesty in acknowledging their shortcomings! Unfortunately the recognition of the problem has not

yet progressed to upgraded qualifications because the appropriate courses and workshops that are available are costly and SLoGBs are not yet prepared to pay for them. As can be seen in Table 5, auditors from just eight SLoGBs (less than a quarter) believe that the currently offered training programs are "sufficient". For auditors from nearly fifty percent of the SLoGBs, the view is that the programs attended are not sufficient at all.

Table 5: Opinion on staff training and development programmes

	Sufficient		Complete		Current	
	Total	%	Total	%	Total	%
Yes	8	22.9	5	14.3	11	31.4
No	17	48.6	16	45.7	12	34.3
No Comment	0	0	1	2.9	1	2.9
No Answer	10	28.6	13	37.1	11	31.4
Total	35	100	35	100	35	100

There is a possibility that the shortage of skills and appropriate development and training programs faced by government internal auditors may be caused by factors other than financial. In one particular interview, it was mentioned that there are not many internal audit related programs available to government sector auditors. This was in dramatic contrast with the many courses for private sector internal auditors, which the interviewees also considered to be superior in content.

Besides the issue of "sufficiency", there are the issues of "completeness" and "current relevance" of the available audit training and development programs. As may be seen in Table 5 above, only five auditors (just over 14 percent) believed the training on offer was "sufficient" and eleven (or less than a third) believed it had "current relevance".

Finally, it may be worth mentioning that in one particular organization, with a relatively long established and well-staffed internal audit function, the one approach being proposed to deal with staff lacking in competency is to re-grade the internal audit position in the organization and to create new posts for the internal audit department. With the presence of an organizational head who appears to be aware of the significant role played by internal audit, it is

expected that such ideas could well be implemented in due time.

6.4 Knowledge elements

When asked about knowledge elements which an internal auditor needs in order to fulfill his or her current role in the organization, as was expected, the majority of those interviewed provided answers consistent with their work environment: i.e. either "traditional" or "modern", as opposed to that of the "advanced" type (as defined by Ridley & Chambers, 1998).

Thus, as can be seen in Table 6 below, the current focus is on issues such as interrogation techniques, types of controls and financial accounting, whereas "advanced" issues, featuring risk vocabulary, concepts and management techniques, globalization and forensic auditing, are not part of the core issues focused on.

But when the auditors from the 35 SLoGBs were asked whether they expected changes in the knowledge elements for internal auditors "in the future", all of them gave positive answers, showing that they expected the future's knowledge elements to be significantly different from those needed in their current working environment.

Table 6: Knowledge elements

Knowledge Elements	Total	%
Interrogation techniques	34	97.14
Types of control (preventive, detective, directive and corrective)	34	97.14
Financial accounting	34	97.14
Auditing and analytical skills	33	94.29
Communication techniques	32	91.43
Legal	32	91.43
Red flags (indicators of fraud such as unauthorised transactions, overrides of controls, unexplained pricing exceptions or unusually large losses)	32	91.43
Types of frauds	32	91.43
Computer technology	32	91.43
Ethics	31	88.57

Cost accounting	27	77.14
Risk vocabulary, concepts and management techniques	27	77.14
ISO framework	25	71.43
TQM	20	57.14
Globalisation	18	51.43
Forensic auditing	15	42.86
Business Improvement Audit, e-Audit	1	2.86
Humanity knowledge, psychology	1	2.86
Practical training in private and public sector	1	2.86
Work procedure, policies and service instruction	1	2.86
Government structure	1	2.86
Technical, i.e. QS and Engineering Skills	1	2.86

6.5 Audit charter

The presence of an audit charter is usually considered of utmost importance for internal auditors and those with whom they interact. This is because this document should at the very least be able to clarify which matters come under the purview of the

internal auditors. It was found however that five SLoGBs (just over fourteen percent) failed to develop such a document. For the rest, twenty-six (over 86 percent) claim that their audit charters specify the types of responsibility or task and the authority held by internal auditors (see Table 7 below).

Table 7: Details of audit charter

	Total	%
The various types of audit responsibility or task undertaken	26	86.67
The authority held	26	86.67
Delineation of procedures of responding to audit reports	19	63.33
Delineation of procedures for issuing audit reports	22	73.33

Interestingly however, sixteen of the audit operations possessing an audit charter (over fifty three percent) are still required to handle other audit tasks not specified in the audit charters. Regarding the specific tasks detailed in their audit charters, auditors from twenty-four SLoGBs (eighty percent of the thirty that have audit charters) stated that the two most popular tasks were appraising the adequacy and effectiveness of internal controls, and assessing the compliance with policies, plans, procedures and law. As for the less popular tasks, these include risk assessment and governance processes, working closely with external auditors, and providing information to outside parties (see Table 8 below).

It was found that for all five of the SLoGBs whose auditors operate without audit charters, their responsibilities or tasks were determined on the basis of management requests and interviews. Their next most popular approach was by reviewing the findings of external auditors (see Table 9 below).

Auditors from all five SLoGBs without audit charters also pointed out that the most popular task they

handled was verifying the existence of assets and their proper safeguards. The less popular tasks were no different from those SLoGBs with audit charters: risks assessment; working closely with external auditors, and assessing the presence of adequate criteria to determine whether their objectives have been fulfilled. Only one or two SLoGBs' auditors stated that these tasks were specified in their audit charters.

It is notable that IT audit appears to be quite unpopular for auditors whether acting with or without an audit charter. Of the twenty four SLoGBs whose audit activities are guided by audit charters only six specify that IT audits are being conducted (see Table 8), while none for those without audit charters say they conduct an IT audit. However, when auditors from all thirty five SLoGBs were asked whether they expected changes in the role and responsibilities of the audit function in the next few years, twenty six out of thirty three (or nearly eighty percent) responded "Yes".

Table 8: Responsibilities or tasks specified in audit charter

Responsibility/Task	Total	%
Appraise the adequacy and effectiveness of internal controls – both accounting and administrative – that are applied in all the activities of the organization	24	80.00
Assess the extent of compliance with policies, plans, procedures and law	24	80.00
Hand in objective and timely reports to the department head so that he/she is informed of the relevant aspects of the organizational position and performance	23	76.67
Verify the existence of assets and proper safeguards for their protection	22	73.33
Suggest steps to improve the working of the governmental body	22	73.33
Ascertain whether the established objectives and goals have been achieved	22	73.33
Review information reliability and integrity	20	66.67
Conduct financial auditing activities separate from those conducted by the external auditors	19	63.33

Appraise the economy and efficiency with which resources are employed	19	63.33
Investigate frauds	18	60.00
Ascertain the proper application of government revenues	17	56.67
Contribute towards the organization's governance process by evaluation and recommending improvements to the manner in which organizational values and goals are established, communicated and preserved, and accountability ensured	17	56.67
Provide advice in setting up policies and procedures	17	56.67
Identify and assess "risks" faced by the organization and analyse and evaluate controls established to respond to such risks	15	50.00
Conduct financial auditing activities in close cooperation with the external auditors	15	50.00
Provide information to the relevant outside agency (such as the Central Authority of Internal Audit for federal government agencies)	15	50.00
Conduct detailed checks on expenditures prior to payment	14	46.67
Assess the presence of adequate criteria used by the governmental entity in determining whether its objectives have been accomplished	12	40.00
Conduct special projects	12	40.00
Some other responsibilities	8	26.67
Conduct information technology audits (IT Audits)	6	20.00

Table 9: Approaches to determining audit responsibilities or tasks when no audit charter exists

How to Determine Audit Responsibilities or Tasks	Total	%
Management interviewed for inputs	5	100.00
Management requests	5	100.00
Arising from findings of external auditors	4	80.00
Rotational approach	3	60.00
Audit risk assessment (covering factors such as quality of internal controls, complexity of operations, length of time since the area's last audit, etc.)	3	60.00
Availability of internal audit hours	2	40.00
Others	2	40.00
External auditor requests	1	20.00
Audit committee requests	1	20.00

It is notable that auditors from 17 of the 24 SLoGBs who expect changes in internal audit, have identified IT audit as likely to be the most popular future task (see Table 10 below). The closest rival tasks for audit

in the future were identified by only nine SLoGBs auditors. These tasks are providing advice in setting up policies and procedures; investigating frauds, and working closely with external auditors.

Table 10: Future audit responsibilities or tasks

	Total	%
Conduct information technology audits (IT Audits)	17	70.83
Provide advice in setting up policies and procedures	9	37.50
Investigate frauds	9	37.50
Conduct financial auditing activities in close cooperation with the external auditors	9	37.50
Contribute to the organization's governance process by evaluating the manner that organizational values and goals are established, communicated and preserved and accountability ensured and proposing improvements to these processes	7	29.17
Assess the presence of adequate criteria for the governmental entity to determine whether its objectives have been accomplished	7	29.17
Identify and assess "risks" faced by the organization and analyse and evaluate controls established to respond to such risks	7	29.17
Hand in objective and timely reports to the department head so that he/she is apprised of the relevant aspects of the organizational position and performance	7	29.17
Review information reliability and integrity	7	29.17
Provide information to the relevant outside party (such as the Central Authority of Internal Audit for federal government agencies)	7	29.17
Ascertain the proper application of government revenues	6	25.00
Conduct detailed checks on expenditures prior to payment	6	25.00
Appraise the adequacy and effectiveness of internal controls – covering both accounting and administrative aspects – that are applied in all the activities of the organization	6	25.00
Appraise the economy and efficiency with which resources are employed	6	25.00
Suggest steps to improve the working of the governmental body	5	20.83
Verify the existence of assets and proper safeguards for their protection	5	20.83
Assess the extent of compliance with policies, plans, procedures and law	4	16.67
Ascertain whether established objectives and goals have been achieved	4	16.67
Conduct financial auditing activities separate from those conducted by the external auditors	2	8.33

6.6 Internal audit execution

There are many signs that the performance of the audit activity leaves a lot of room for improvement. First, over one-third (or 12) of the SLoGBs' internal auditors have no regular meetings with top management (see Table 11 below). But of those

interviewed who did confirm meeting with top management, they usually noted the presence of many other parties in such meetings, including the head of the organization, the various heads of the departments, the head of internal audit department or unit, amongst others.

Table 11: Regular meeting with top management

	Total	%
None	12	34.29
Fewer than 3	2	5.71
Between 3 and 7	14	40.00
Over 7 times	7	20.00
Total	35	100.00

Second, regarding the identification of auditable areas within the organization, a third of the SLoGBs with audit charters failed to conduct a risk assessment

(see Table 12 below). Again from Table 12 the most popular approach to identifying auditable areas was by referring to previous audits.

Table 12: How the problem/auditable areas are identified

	Total	Entities with audit charter (30)	Entities without audit charter (5)
Previous audit results	32	28	4
Management requests	27	23	4
Cyclical audit	26	23	3
Risk assessment factors (such as quality of internal controls, complexity of operations, last time audited, etc.) deemed high	24	20	4
Alleged irregular conduct occurred	18	17	1

Another sign that all is not well in internal audit in SLoGBs is the fact that internal auditors from five SLoGBs (just over 14 percent) were not given access to certain sections of their organizations. It is also worth noting that in one particular interview it was stated that there was no obstruction to access. In the next breath the interviewee stated that access "...depends on CEO's final say." Another interviewee stated that there was no obstruction to their accessing all sections of the organization. This was immediately qualified by the statement: "except for the office of the Mayor."

On the positive side, over thirty internal audit heads stated that the following activities were among those that routinely took place during their auditing: performance of follow-up audits on all audit findings after the presentation of the audit report; discussion of recommendations with the auditee, and the development of recommendations whenever appropriate.

It is discouraging to find that certain activities usually expected of internal auditors are not that frequently performed (see Table 13 below). Thus, the following audit tasks are seldom considered during the planning stage: the potential fraud risk; reviewing of audit working papers by senior auditors, and assessing risk.

This should augur well for internal audit in the SLoGBs concerned. But on further investigation the sad reality is that there is a lack of organizational openness towards changes in a number of SLoGBs. As emerged from several interviews, the audit findings are always considered to be of little importance by auditee organizations. This is probably because nobody in higher authority has shown interest in whether or not an auditee implements the suggestions made by the auditor. As a result, the release of the audit report is essentially the end of the audit process.

Table 13: Specific activities undertaken when auditing

	Total	%
Conduct interviews	34	97.14
Prepare audit report	33	94.29
Prepare annual audit plan detailing the auditable areas, the resources required and duration of each audit activity during a calendar year	33	94.29
Review prior audit reports and other relevant documentations	32	91.43
Develop work papers	31	88.57
Perform follow-up audits on all audit findings sometime after the issuance of the audit report	31	88.57
Discuss recommendations with auditee	31	88.57
Develop recommendations when appropriate	31	88.57
Disseminate audit outcome to the appropriate individuals	29	82.86

Require written response from auditee (to include among others plans for corrective action and the date by which action will be implemented)	29	82.86
Maintain an awareness of the potential for fraud while auditing	29	82.86
Use audit aids such as flowcharting, internal control questionnaires and checklists	29	82.86
Evaluate the relevance, sufficiency and competency of evidence	28	80.00
Monitoring the progress of audit work	27	77.14
Use computer	25	71.43
Consider the potential for fraud during planning stage	24	68.57
Perform Analytical Review Procedures	24	68.57
Review audit work papers by senior auditors	24	68.57
Execute judgmental sampling	22	62.86
Execute statistical sampling	21	60.00
Use risk assessment technique to inform the audit planning and resource allocation process	17	48.57
Some other operational details are executed	4	11.43

The internal auditors' assessment of their current performance corresponds closely with the organizational and structural problems and obstructions discussed above. Thus, as can be seen

in Table 14 below, internal auditors from 14 SLoGBs (forty percent) could only manage to rate their audit performance as "Average".

Table 14: Performance of internal audit department or unit

	Total	%
Excellent	5	14.29
Good	16	45.71
Average	14	40.00
Weak	0	0.00
Very Weak	0	0.00
Total	35	100.00

A clear indication that there is a lot of room for improvement in internal audit in the SLoGBs – aside from the fact that a mere 35 out of 202 of them in Peninsular Malaysia have an internal audit department or unit - is the fact that auditors from 22 SLoGBs (or over sixty percent) said that there was no assessment program that covered "all" aspects of the internal audit activity and which "continuously" monitored its effectiveness. Among those auditors who said that there were assessment programs taking place, one claimed that it came in the form of examination by internal auditors attached to the state government, and included the presentation of a report on the function, tasks and effectiveness of internal audit at the state's exco meetings.

6.7 Audit independence

For both external and internal auditors, their independence from those whom they audit is crucial for the success of their function. For internal auditors it is more difficult to achieve independence because they are actually employees of the organization they audit.

Thus, it is surprisingly pleasant to find that auditors from twenty-five SLoGBs (over seventy percent) say that the internal audit function is placed high up the organizational chart. Also, audit findings are frequently communicated with relevant parties for all SLoGBs. In each organization this is a formal, written report, and in a majority of cases (31 or almost ninety

percent) the recipients are the organizational heads. In five cases, the written reports are supported by oral presentations. In thirty-one SLoGBs (or almost ninety percent), the written reports include the management action plan which clearly identifies for each recommendation, the actions to be taken and their timing. In cases where no such action plan is presented, two of them claim that the parties mentioned in the report are required by the organizations to respond to the reports by filing action plans or other responses to parties such as the heads of the organizations, the audit committees, or heads of internal audit departments.

As can be seen in Table 15, it is also particularly encouraging to find that in 30 cases (just over 85 percent), the auditors are in fact required by the organizations to monitor whether or not the recommendations made in the audit reports have been acted upon. In one particular case, an auditee was given two weeks to respond to an audit report. And two weeks after the response had been made, the auditor was required to verify whether the auditee had in fact taken the needed action. Unfortunately, there are also four cases (just over eleven percent) where the auditors are not required by the organizations to do follow up, and neither has anyone else in the organization been asked to do the monitoring. In one additional case, the participant failed to provide any answer. Here, it is also likely that no follow up is performed or expected.

Table 15: Audit monitoring of the actions taken up by the relevant parties upon recommendations in the audit report

	Total	%
Yes	30	85.71
No	4	11.43
No Answer	1	2.86
	35	100.00

Besides the monitoring issue, there are other issues affecting independence, and faced daily by internal audit personnel in SLoGBs. From a list of questions where answers were either "Yes", "No", "No Comment" or "Others", it was found that in four SLoGBs (just over eleven percent) the auditors were not able to say that they were "free" to allocate resources, set audit frequencies, select subjects, determine scope of work and apply appropriate

techniques to accomplish the audit objectives. Also, in four SLoGBs the auditors were unable to say that they were "free" to obtain the necessary assistance of personnel in areas of the organizations being audited; and, in seven SLoGBs (twenty percent) the auditors failed to say that they were "free" to produce audit reports where the contents might not be to the liking of those associated with the organizations they come from (see Table 16a below).

Table 16a: Independent issues faced by audit personnel

	Yes	%	Other than Yes	%
Face no obstruction to audit regardless of offices, records, property and personnel	33	94.29	2	5.71
Have regular access to senior personnel	33	94.29	2	5.71
Free to allocate resources, set frequencies, select subjects, determine scope of work and apply the techniques required to accomplish audit objectives	31	88.57	4	11.43
Free to obtain the necessary assistance of personnel in areas of the organization where audits are performed	31	88.57	4	11.43
Free to produce audit reports where the contents may not be to the liking of individuals or groups working or associated with the organization	28	80.00	7	20.00

Doubts about audit personnel's independence may also arise in another two situations (see Table 16b). First, auditors from six SLoGBs (just over 17 percent) were not able to say that they were "free" from performing operational tasks such as preparing inventory records and other basic accounting department functions.

Second, auditors from 16 SLoGBs (nearly half) were unable to state that they are incapable to direct the activities of personnel outside their audit departments or units who have not been assigned to assist them.

Table 16b: Additional independent issues faced by audit personnel

	No	%	Other than No	%
Perform operational duties for the organization or its affiliates such as compiling inventory records, participating in departmental procurement boards, involvement in accounting process, etc.	29	82.86	6	17.14
Direct the activities of any organization employee not employed within the Internal Audit Department – except to the extent such employees have been appropriately assigned to assist the internal auditors	19	54.29	16	45.71

The fact that there are issues worth considering about the independence of internal auditors in SLoGBs may be clearly seen from the fact that auditors from 14 SLoGBs acknowledged that they have encountered threats in their jobs. Auditors from nine SLoGBs mention that these threats include scratching of their cars, puncturing the tires, verbal abuse and abusive SMSs.

The final issue regarding the independence of internal auditors in SLoGBs is concerned with answers that appear to contradict interviewees' other answers in the interview sessions.

- With regard to obstructed access to auditing offices, records, property and personnel, auditors from only two SLoGBs claimed that their audit activities were restricted by the organizations (see Table 16a). But earlier when they were asked whether there were sections in their organizations which were off limits, auditors from **five** and not two SLoGBs agreed that there were such sections.
- Also, in regard to the question of whether audit personnel have frequent access to senior management, auditors from two SLoGBs indicated that they did **not** have frequent access (see Table 16a), although earlier, auditors from "all"

35 SLoGBs claimed to communicate frequently with relevant parties on audit findings.

- There was also one particular case where, in the closed-ended section of the interview session, the responses indicated that the internal audit personnel do not conduct operational activities for the organization. However, in the open-ended section of the interview, the responses clearly indicated that the head of the organization specifically assigned the audit head the task of preparing group accounts for the organization.

6.8 Audit - non-audit personnel interaction

Auditors from 18 SLoGBs (fifty one and a half percent) feel that the level of support and cooperation from other parties inside the organizations is actually good. In strong contrast, auditors from 13 SLoGBs (or just over 37 percent) either agree or agree strongly that there is *little* support and *minimal* cooperation from others in the organizations being audited. Again, auditors from nearly seventy five percent of the SLoGBs either agree or agree strongly that there is a lack of understanding of the role of internal audit as independent appraisal function in the organizations (see Table 17a). Many say that the internal auditor is viewed by non-audit personnel as mainly interested in finding out other people's faults. One particular interviewee stated: "The head of department does not

disseminate information and understanding to all members of the department."

Finally, from the closed-ended section of the interview, auditors from 25 of the SLoGBs (just over 71 percent) either agree or agree strongly that there is a lack of appreciation of the value and importance of internal audit in the organizations (see Table 17a). One interviewee stated: "They just focus on profit centers."

The need for improved co-operation and understanding between internal auditors and their clients, revealed in the closed question portion of the questionnaire, is confirmed by various comments made in response to the open-ended questions. Many of these comments are concerned with the negative perception held by non-audit personnel: as an interviewee pointed out, auditors are believed to be interested in nothing more than looking for other people's mistakes. In another interview, it was mentioned that the prevailing view among non-audit personnel was that the work of internal auditors has made their work more complicated than necessary. In other words, they have the perception that their work would be easier without auditors.

Table 17a: Audit - non-audit personnel interaction

	Strongly Agree		Agree		Not Sure		Disagree		Strongly Disagree	
	Total	%	Total	%	Total	%	Total	%	Total	%
There is little support and minimal cooperation coming from others in the organization for the Internal Audit Department to be able to conduct its activities successfully.	1	2.9	12	34.3	4	11.4	17	48.6	1	2.9
There is a lack of understanding of the role of internal audit as an independent appraisal function within the organization.	7	20	19	54.3	3	8.6	6	17.1	0	0
There is a lack of appreciation of the value and importance of the Internal Audit Department in the organization.	5	14.3	20	57.1	5	14.3	5	14.3	0	0

Some other comments raised by interviewees concerned those auditee staff whose jobs and performances were commented on (negatively) by the internal auditors. Typical responses to the audit report include "necessary actions shall be taken", but nothing further happened, or that "this matter shall be made certain to never recur", but are in fact allowed to reoccur year after year. But with no power to ensure that the auditees make good on their undertakings, and with little more than silence from higher up the organisation, the internal auditors have very little option except to suffer in silence.

Fortunately or unfortunately, this occurs most often in "ordinary cases" such as "records not up-to-date". In cases considered "serious", the internal audit heads may resort to sending of appropriate letters "higher up". Problems may occur however when those matters raised relate to the performance of those high up in the organizations concerned. These people, frequently on a higher salary grade than the internal audit head, "pull rank" and have the auditors

admonished for having dared to write such reprimands!

6.9 Audit – top management interaction

It is our contention that the two problems of under-staffed internal audit departments and of internal audit staff with inadequate skills could be overcome if the heads of the organizations possessed the intention and will to get the best for and from their departments. Similarly, the negative perception of internal auditors as fault-finders whose comments can safely be ignored, could be reversed if organizational heads were to actively support and place positive value on the activities and reports of the internal audit personnel, providing "leadership by example".

In reality however such supportive organizational heads are hard to find in SLoGBs. In fact many organizational heads seem to actively sabotage the viability of the internal audit process by ensuring that the departments are under-staffed, and that those

staff they do see fit to employ are juniors and/or have minimal audit experience. In a few cases the audit personnel are further burdened with duties unrelated to auditing, with the objective of preventing the audit from occurring.

In one particular organization the audit head has on several occasions requested permission from his superiors to hire additional staff. The standard response has been that not many people are interested in coming to work in a location where the cost of living is rather high, so there is no point in advertising for staff! It is also worth noting that in this particular organization, the head of audit who is supposed to report directly to the organizational head, has in fact never had so much as a single meeting with him, even though the internal audit function was established several years ago! It is therefore not surprising that the audit head comments that he/she finds it difficult to interpret his superior's attitude towards the internal audit department: whether its presence or absence would have any material impact on the functioning of the organization as a whole, and that there has as yet been no opportunity to show him what the internal audit department actually does.

It was also not clear to the audit head whether his superior simply had no time for or no interest in the audit department. With no contact whatsoever with the organizational head, the audit head is left to decide what the audit focus should be. Not surprisingly this is the familiar financial management aspects of the organization. It is only quite recently that the focus has changed from financial management to other responsibilities that supposedly come under the purview of an internal auditor. Perhaps nothing better illustrates the insignificant value the organizational head places on internal audit than the fact that the auditors are sited in a decades-old wooden structure next to the main building!

In spite of this poor treatment, compared to a few others, all is not quite lost for internal audit in this organization. This is because the auditors are still able to audit whichever departments, records, assets and personnel they see fit. They are also free to allocate resources, determine audit frequency and other related matters. Finally, they are free to produce audit reports even when their contents may not be to the liking of certain parties in the organization. What is also satisfying is that the departmental heads within the organization have rarely failed to implement the suggestions made by the audit head. This is probably because the audit head was previously attached to the National Audit Department, and was the external auditor for the organization.

It is notable that for reporting purposes, he/she sends the reports to both the state's treasury unit and to the branch office of the National Audit Department, which is located nearby. No such reports are however issued to the organizational head.

This experience is probably typical of audit units in general, where, on paper, the internal audit function is supposed to file reports to the organization's head,

but for one reason or another, the audit reports are not sent to the organization's head.

The submission of the audit reports to the organizational head does not, however, guarantee that they will be read. There is widespread apathy towards audit reports amongst heads of SLoGBs. This was mentioned by many of those interviewed, and obviously contributes to the undermining of and contempt for the internal audit function. As stated by an audit head:

If an auditor were to get a full mandate [from the CEO] and the audit report were to be checked and monitored by the CEO, this would lead to the audit report being taken seriously. On the other hand, if the CEO does not give a reasonable level of mandate, the auditee is not usually bothered about the report and the function played by the internal auditor.

One audit head reported that top management on one occasion put the audit report in 'cold storage' for a year. Another interviewee reported that the organizational head was inclined to side with the auditees whenever they were proven by the auditor to have failed to follow organizational procedures. One of the audit heads interviewed explained that this was because the organizational head needed support from the various departmental heads in order to retain his position as the head of the organization! Obviously this has eroded the auditors' confidence in the process, and the lines of authority.

In addition to organizational heads failing to take audit reports seriously, there are others who expect the auditors to file reports on staff misconduct even though they have been aware of such misconduct all along. Worse, there are cases where heads of organizations have cultivated outside associations, or have succumbed to outside pressure (including political) that has persuaded them to ignore the findings of misconduct by the internal auditors.

This auditor is from a state well-known for the corruption of its civil servants and politicians, as attested to by numerous exposés in the media. "Political interference" here refers to situations where heads of government organizations suspend standard operating procedures regulating transactions with operators outside government, and with individuals (who may very well be politicians). In other words those in authority in the government sector are colluding with those in the private sectors to the detriment of the organization's public interest imperative. This obviously supports the perception that the concerns of audit personnel are immaterial to those in higher authority. In fact, as one audit head stated, he/she is expected to subscribe to the "SYMP" protocol. SYMP stands for "Saya Yang Menurut Perintah" in the Malay language and normally appears at the end of official letters issued by civil servants, just before their signatures, and meaning "I who follow instruction".

Political interference is also prevalent in the form of protection of the special interests of politicians and

their protégés. As described by an audit head, he/she once confronted the enforcement unit of his organization for having failed to take appropriate corrective actions that were well within its jurisdiction. He/she was promptly informed that the unit had been instructed by certain politicians not to proceed with the action. (These politicians were obviously concerned about the wellbeing of their associates and their "mutually beneficial" projects). Being political appointees, the organizational heads and others in top management would rather stay passive and compliant to the will of their corrupt associates outside the organization in order to be assured of their ongoing appointments. As stated by an internal auditor, in such an environment – where race is also an extremely influential factor deciding what may or may not take place - so many of the laws, regulations, policies and processes are "benda kosong dan tidak bernyawa" (vacant matters and lifeless), with form but no substance. That is, laws, regulations and policies are only enforced when they benefit the interests of top management and its outside associates. These internal auditors are certainly not in an enviable position.

It may never ever be fully known to what extent political interference affects the internal audit process in SLoGBs since gathering such data is problematic. However, one auditor, in response to the request to identify high risk factors undermining the internal audit objectives, volunteered the word "ahli politik" (politician). It is also notable that the *NST* (12 October 2004) filed a report (under the heading "'Stop Meddling', Politicians Told'), of the shameful political interference in the activities of local authorities. The newspaper story opens:

Politicians must stop interfering with the functions of local authorities. Minister in the Prime Minister's Department Tan Sri Bernard Dompok said there had been cases when complaints from the public could not be looked into because of meddling politicians. He/she said the 'influential people' had disrupted enforcement activities and investigations into anomalies. This has caused delays in government departments looking into public complaints ...

Notwithstanding all the horror stories, there are also some cases of organizational heads of SLoGBs who provide strong support for their internal auditors. One recently formed internal audit department has, in a

few short years been able to uncover cases of mismanagement and fraud involving millions of Ringgit. The employees caught have also faced disciplinary actions. Not surprisingly perhaps, according to the audit head during his interview, the internal auditors received very little cooperation from other employees while conducting their audit tasks. As the audit head said, the auditee does not view the auditors as colleagues working together to enhance the efficiency and the effectiveness of the organization. It is therefore not surprising to find that the internal auditors have received threats from these employees and that their cars have been scratched at times. However, because of the strong support from the organizational head, and the audit head's regular meetings with him, the audit personnel have managed to ignore the intimidation, and to perform their duties effectively.

This particular organization is a success story because its head selected the right person to head up the internal audit department. In addition, with the support of interested parties from both inside and outside the organization, the internal audit report findings get the attention that they deserve. The twenty plus years of external audit experience the audit head brought to his post, and his high level of motivation has resulted in the development of various audit programs and check lists that are also being used by other audit departments both within the state and elsewhere within Malaysia's public service organizations. When the audit head was asked to assess the performance of his audit department, he/she simply said that it was "excellent"!

Despite the very many sad stories of ineffectual internal audit/top management interactions in SLoGBs, determined from answers provided to the questions raised in the open-ended section of the interview, the answers to the three closed-ended section questions regarding aspects of the interaction have provided a rather rosy picture.

Table 17b below shows that auditors from 27 SLoGBs (or just over 77 percent) either agree strongly or agree that top management recognizes the audit's value. Also, in regard to the implementation of audit recommendations and feedback from management, auditors from 30 SLoGBs (over 80 percent) either agree strongly or agree that these are "usually" and "sufficiently" implemented.

Table 17b: Audit - top management interaction

	Strongly Agree		Agree		Not Sure		Disagree		No Answer	
	Total	%	Total	%	Total	%	Total	%	Total	%
Top management recognizes the accomplishments of the Internal Audit Department.	16	45.7	11	31.4	8	22.9	0	0	0	0
The recommendations by the Internal Audit Department are usually implemented by the relevant parties in the organization.	9	25.7	21	60	3	8.6	1	2.9	1	2.9
The Internal Audit Department receives adequate feedback from management on its audit findings and recommendations.	8	22.9	21	60	1	2.9	4	11.4	1	2.9

7 DISCUSSION

In early 1997 it was reported that the Housing and Local Government Ministry wanted all local authorities to set up internal audit units to help monitor and supervise financial management in line with established procedures (*NST*, 20 February 1997). The Minister was also reported as saying that the units would be vital in ensuring that annual financial reports could be prepared by the closing dates. In this study, it was found that by the third quarter of 2003, there were only 15 local governments in the Peninsular Malaysia with an internal audit function. This may be due to the fact that in at least two states (Perak and Johor) in Peninsular Malaysia, the internal audit function of local governments is conducted by the internal audit departments or units attached to the two state governments. Such an arrangement appears to bring no real comfort, however, since the internal audit function in the majority of the 9 state governments and their 10 statutory bodies operate with limitations similar to those found in the majority of the local governments that possess internal audit departments or units.

The severest problems plaguing SLoGBs are concerned with the shortage of audit staff and of staff lacking in audit competencies. In many organizations, the obstructionist attitude of non-audit personnel and top management has also managed to make it difficult for the auditors to perform their duties. Other problems concern the availability and quality of appropriate training and development programs and that audit approaches used are significantly out of date. Audit independence is more of a hope than a reality in a number of organizations. All in all, there is a pressing need for an overhaul of the internal audit function in SLoGBs, whether they have a recognized internal audit function or not.

Perhaps this overhaul should extend to other government entities too, for the view held by those interviewed in this research project is that the audit weaknesses are not unique to SLoGBs. An audit head interviewed in this research project said that there are internal audit departments or units that function effectively. But most in the government sector are not effective because they are largely not supported by their superiors, and their roles are insufficiently defined. In fact, some internal audit departments or units – especially those located in state governments and local authorities – are not independent in the conduct of their work.

Another audit head who says that the practice of internal audit is not widespread in the public sector also pointed out that the internal audit function does not enjoy much support from top management. His view of the sad state of internal audit in SLoGBs is that top management is responding to federal government pressure to set up the internal audit unit, and is not doing it from any desire to see any changes that might result from having a fully functional and effective internal audit unit. In his opinion SLoGBs' top management are not serious at all.

Apparently, at a special meeting on the 9th October 1999, the federal government's Director-General of the Treasury and the states' financial officers agreed on the setting up of internal audit units at the state government level. This decision was in response to repeated comments by the Auditor-General condemning the ongoing weakness of financial management controls and the consequent financial malpractices. Auditors from a number of SLoGBs interviewed for this research project acknowledged the existence of this directive, requiring an internal audit function comprising four staff members, in all state governments. Unfortunately, there has been little direction or intent from any party to implement a uniform internal audit practice throughout the state governments. Worse still, there seems to be little comprehension that a department comprising four audit personnel may be so small in comparison to the audit coverage required, measured by expenditure or number of employees of a state government, as to doom the audit process to failure from the start.

Thus, it is hard not to agree with an audit head's view that the state of internal audit practice in the government sector as a whole is kept in check by the political agenda. Apparently special interests in society have managed to undermine the internal audit function throughout the government sector. Obviously these parties profit best when the internal audit function is least effective.

Not surprisingly, when asked his view of the future of internal audit in the government sector, the interviewee said that it would improve when a desire for excellence developed. The absence of an environment appropriate for the effective emergence of a well functioning internal audit department in SLoGBs is discussed next.

7.1 Contextually wrong

For audit to be successful it needs to operate in an environment where transparency and public accountability are normal occurrences. Azham (1999) has made this painfully clear in regard to the practice of external auditing. The same may be inferred for internal auditing in the public sector in Malaysia. Unfortunately, Malaysia still has a long way to go to achieve this. The recent Corruption Perceptions Index (CPI) compiled by Transparency International (*NST*, 25 October 2004) ranks Malaysia 39th in a list of 146 countries (and is ranked fifth among Asian countries after Singapore, Hong Kong, Japan and Taiwan).

This is a drop of two places compared to the previous year and a drop of 0.2 points on a scale of 1 to 10.

Though the index is only an appraisal of the extent to which corruption is perceived by businessmen and other groups, it is logical that such a perception is derived from experience. For the last decade Malaysia's score has hovered around five, indicating a borderline "serious" corruption problem. It is probable that corruption is endemic here, and that the perpetrators have enjoyed the protection afforded by a culture that does not demand openness or full disclosure in its transactions, and where those with

status and political affiliation are seldom charged or successfully prosecuted.

All this is part and parcel of Malaysian life as Tunku Abdul Aziz Tunku Ibrahim, the executive president of the Malaysian chapter of Transparency International made clear in an interview with the *NST* (24 October 2004). (Tunku Abdul Aziz Tunku Ibrahim was the founder of the Kuala Lumpur Society for Transparency and Integrity in 1995.) When asked whether he was happy with what has been done in curbing corruption within the country he replied: "I feel our country can do better." Some of his other observations were that Malaysia was perceived as not being serious about curbing corruption. To illustrate this Ibrahim pointed out that there were people living beyond their means, beyond what their salaries could sustain, with the balance coming from "unethical practices". That nothing was done about this has undone a lot of good work. Ibrahim did draw the interviewer's attention to the fact that the new Prime Minister of Malaysia's anti corruption statements were "... not rhetorical. This man means business ..."

In a recent workshop at Universiti Utara Malaysia Zakaria Haji Mohammad Nor, Audit Director for Kedah State, highlighted the lack of transparency and accountability in the public sector (Zakaria, 2004). He also mentioned various problems and challenges that he and his colleagues from the National Audit Department have had to face in trying to improve accountability in the public sector. These included the lack of accountability of the heads of these public organizations: their failure to attend the audit exit conference; to respond to audit recommendations, and their failure to take appropriate actions arising from cases reported.

With this style of leadership, problems elsewhere in the system are inevitable. Some of these are the lack of cooperation from the audit clients, and the failure of these civil servants to rectify their mistakes. The list of the ten most significant problems facing the National Audit Department confirms the negative impact of the organizational heads and their subordinates. Items of key importance are the weaknesses at the level of Public Accounts Committee (PAC); the failure to implement the surcharges (of RM4000) if a department fails to complete its accounting and of RM5000 if it fails to present its books for audit (interview with the Auditor-General in the *NST* of 18 October 2004) and, prior to Datuk Seri Abdullah Badawi becoming the Prime Minister on 31 October 2003, the lack of transparency in government administration.

With all these underlying problems it is hardly surprising that local newspaper articles depict state and local government as being bogged down in self-serving corruption. For instance, just from the *New Straits Times*, the following recent headlines paint the picture that these local government entities have repeatedly failed the people: "Buck Up, PM Tells Local Councillors" (28 October 2003); "States Should Expose Corrupt Officials of Local Authorities" (8 July 2003); "More Enforcement Staff at MPAJ Could Face

the Axe" (14 June 2003); "Council Officers Warned" (10 June 2003); "Blowing Whistle on Local Councils" (10 June 2003); "Local Councils Should be Accountable to Residents, Says Rais" (9 June 2003); "ACA Plan to Curb Graft in Local Councils, Land Offices" (7 June 2003); "Take Grouses Seriously, Rais Warns Councils" (5 June 2003); "Local Councils Taken to Task for Delays in Implementing Decisions" (10 January 2003); "PM Raps Local Authorities" (21 December 2002); "Inefficiency Causing Financial Weaknesses" (17 April 2002); and, "Local Authorities Urged to be More Transparent and Shun Corruption" (30 August 2000). Two of them - "Council Officers Warned" (10 June 2003) and "PM Raps Local Authorities" (21 December 2002) - were front page lead stories.

Reports on the state governments provide the same picture. Several of these stories in the *NST* closely reflect the audit reports issued by the Auditor-General. A sample of recent *NST* headlines illustrates this: "States Reprimanded Over Handling of Finances" (3 August 2004); "Water Corporation's Financial Management Found 'Unsatisfactory'" (11 November 2003); "A-G: Kedah Finances in Unstable Condition" (19 March 2002); "Kelantan Government Not Transparent, Says Audit Report" (14 November 2000); "Poorly Kept Accounts: Malacca Has Yet to Learn From Past Mistakes" (20 June 2000); "Errant Financial Officers Warned" (8 June 2000); and, "Weaknesses in Financial Management" (7 April 1999).

Other *NST* reports on state governments, independent of the Auditor-General's audit reports, also provide a picture of governance failure. Some illustrative headlines: "Several Government Departments Inept in Preparing Financial Reports" (9 April 2004); "Malacca Warns Accountants" (17 November 2003); "Assets Missing From Agency" (26 September, 2002); "Inept Civil Servants Will Face Dismissal" (5 April 2001); "Close Watch on SEDCs" a front page report, (23 December 2000); and, "Act Against Those Who Misused Fund" (28 April 1998).

From an examination of the Auditor-General's reports, it appears that various state governments have been consistently "wayward" in their approach to accounting, auditing and reporting. From the National Audit Department's website (www.audit.gov.my) in the first quarter of 2004, the following closing statement appears in six audit reports: for Kedah and Negeri Sembilan (15 October 2001, p. 108); for Terengganu (5 October 2001, p. 103); Kelantan (11 September 2001, p. 93); Malacca (August 30 2001, p. 16) and Perlis (11 August 2001, p. 100).

The outcome of this year's audit shows that the weaknesses reported in years past are still around in the Departments/Agencies visited. These include the failure to maintain accurate financial records, the failure to observe prescribed procedures, and the inefficient and ineffective management of activities. The weaknesses that take place are caused by the lack of supervision and monitoring of work performed by the lower rung staff.

The Kelantan state government's audit report of 20 December 1999 has the following Conclusion (p. 20):

The Level of Financial Management at the government departments and agencies is still not satisfying.

7.1 At the level of State Government Departments, weaknesses in putting control over allocations, administration of votes, expense control, revenue administration, lending and management of trust accounts and deposits are still around. These weaknesses have been mentioned repeatedly, indicating that the State Financial Authority has not yet taken widespread, effective and continuous action.

7.2 Local Councils and State Statutory Bodies also show the same weaknesses, that is, expense control and revenue administration are still not occurring effectively and that some financial regulations have still not been fully complied. In addition, the published financial statements have a lot of errors. Records keeping and accounts are inefficiently organized and are not up-to-date, and this has led to the issuance of audit *disclaimer* reports for some of them. (Emphasis in the original.)

The state government of Perak's audit report (18 September 2000) shows the ongoing sad state of affair within the government:

2. Overall, the financial management of the State Government at the level of State Treasury still has weaknesses particularly in regard to control over revenues and expenses. The Land Office of Hilir Perak and that of Lenggong are also weak in financial management and in the administration of financial records. As a result of weak internal control systems, the loss of public funds totaling RM100,045 has taken place at the Land Office of Hilir Perak.

Selangor state's audit report's conclusion includes the following (26 September 2001, p. 12):

Overall, the quality for the Selangor State Statement of Public Accounts for the year 2000 does not show clear improvement. There are still several Trust and Deposit Accounts which cannot be validated due to the absence of supporting documents during auditing. Fixed deposits, amounting to RM4 million, was not supported by certificate or bank's confirmation letter, while the buying of shares, amounting to RM12.25 million, is not shown in the Statement of Public Account. The State Treasury needs to try harder in ensuring that supporting documents are kept more systematically and made up-to-date.

Given the overall conditions in state and local governments and in the nation as a whole, it should be clear that the environment for the effective functioning of internal audit in SLoGBs is not good. For those used to examining problems in isolation the

need for a supportive environment might not seem obvious as a prerequisite to improving the functioning of internal audit in SLoGBs. In other words, the current predicament faced by internal auditors in SLoGBs is a reflection of the prevailing socio-political environment, which is characterized by those in power showing little interest in ensuring good governance. There is an enormous gap between "espoused theories" and "theories-in-use" amongst the country's leaders. Unfortunately, the general population appears to have resigned itself to this ongoing bad management and poor delivery. There are theories to explain the behaviors within the unbalanced relationship between the powerful few and the disempowered majority.

7.2 Theoretical explanation

The conduct of those in power and others who put them there can be explained using the politics of accountability theory and Hofstede's cultural dimension of power distance, respectively. Under politics of accountability theory, political representatives, appointed officials, administrators and workers have good reasons to resist attempts to expose their work to scrutiny. As stated by Schwartz and Sulitzeanu-Kenan (2002), their interests in presenting a façade of organizational stability, budget maximization and the promotion of favorable image, contribute to a general desire to oppose accountability mechanisms such as internal audit that might portray deficiencies in their work. This would explain why, in Malaysia so many of the SLoGBs operate without an internal audit function. For the majority of those which do possess an internal audit function their experience is that management has made it impossible for them to function well, because of, amongst others, a severe (and artificial) shortage of staff, and the lack of audit competence.

That Malaysian society in general condones the lack of accountability from the powerful may explain in part why the internal audit function in SLoGBs is in a quagmire. Hofstede (1991) discusses five important cultural dimensions that explain the general similarities and differences in cultures around the world. One of these, the notion of power distance, helps define the behaviors of those with less and more power within a society. Specifically, the concept of power distance refers to the degree to which people are willing to live with unequally distributed power within and across their institutions and organizations. A high score on the power distance index indicates a national culture that has a high tolerance for inequality. In short, the people accept the hierarchical order in which everybody has a place which needs no further justification. In the two surveys conducted between 1968 and 1973 amongst employees from subsidiaries of IBM in sixty-four countries and which involved 116,000 questionnaires in twenty languages, Malaysia received the highest score, ranking first for power distance (Hofstede, 1983). It would therefore appear probable that the majority of Malaysians accept as normal situations that would be totally unacceptable in societies where the power distance is relatively small.

More to the point, internal audit in SLoGBs, a tool of internal accountability, remains in a state of limbo and of no benefit to the powerless, even after more than forty years of independence from Britain. In most cases, the audit function and its potential benefits is not taken seriously either inside or outside of the organizations. The few inspiring success cases are really the exception to the norm of the audit function which is marked by shortages of staff and audit skills, and obstructive and unsupportive bosses and non-audit personnel. The powerful enjoy their lack of internal accountability, a situation that can only exist when the internal audit function is hamstrung. On the other hand, the powerless members of the organizations and society as a whole have resigned themselves to their fate as impotent bystanders, unable to bring about much change to their situation.

Ultimately it is still unrealistic to expect the future of the internal audit function in SLoGBs to be much different from its present. This is related to the fact that in societies with an unequal power distribution, the status quo is maintained because it satisfies the psychological need of the powerless to depend on someone more powerful. In other words, there is a symbiotic relationship between the two groups. Surprisingly however, auditors interviewed from every single one of the SLoGBs expressed optimism regarding the future of internal audit, not only within their own organizations, but also in the government sector as a whole.

7.3 The audit future

Though available evidence points to a bleak future for internal audit in SLoGBs, the internal auditors themselves believe that the function has a bright future. All in fact believe that internal audit functions should be set up in all government agencies. In one particular interview, it was mentioned that internal audit will become increasingly vital because the rising educational level of the general public is powering the demand for transparency in all aspects of government administration. In this organization there is already the trend for more and more cases to be sent to the internal auditors for investigation.

In another interview, an audit head who appears to operate quite a successful audit operation, also said that the future for internal audit looks bright. In his view this is because the government is aware that the reports issued by internal auditors will enable it to improve its operational efficiencies and effectiveness – particularly in a world becoming more challenging than ever before. This means the internal auditor could be involved in implementing better corporate governance practices, overseeing the wise spending of public money, and collecting revenues optimally.

It is also noticeable that for a small number of those interviewed, there is no turning back for the internal audit function. This is because they seem to have already made significant contributions to their organizations. In one particular interview it was mentioned that non-audit staff in the organization remind each other that they need to be careful to conduct themselves in accordance with regulations –

or else the internal auditor may reprimand them for their inappropriate conduct. Also, in this organization and a few others, the internal auditors have increasingly been asked to provide fellow employees with input regarding the proper interpretation and application of organizational procedures. In another organization where there appears to be quite a successful audit operation, the non-audit personnel appreciate the auditors' constructive criticisms. In particular, it was mentioned during the interview that the work done by internal auditors has led to many changes taking place in the conduct of the financial management of the organization.

Those optimistic about the future of internal audit are not naïve, as is proven by their recognition of how much more still needs to be done to ensure the future of internal audit in SLoGBs. They point out institutions of higher learning, media operators and the internal auditors themselves still have to play their role. Also, the setting up of statutory audit committees and an audit monitoring body should be considered. (See further discussion on this topic in Azham *et al.* (2004)). Many also believe that the federal government in particular has a crucial role to play. This is discussed next.

7.4 The federal government and internal audit in SLoGBs

Many auditors say that there is little hope for real change to take place in internal audit in SLoGBs if the motivation or pressure for change comes solely from within the state and local levels of government. They believe that the federal government should spearhead the needed changes.

One of the most important changes involves the understanding, among all levels of civil servants, of the significance of the role of internal audit in the public sector. At present not many parties in SLoGBs have a high regard for internal audit. One of the interviewees for this research pointed out that ... "in local authorities, audit is not highly regarded – it merely exists. Its importance is not that obvious." On suggestions contained in the audit reports in particular, he/she said that the prevailing attitude was that it was of no consequence whether they were followed or not.

By encouraging the recognition of the internal auditor, not as one who makes life difficult for others, but as one who is a "partner" with others, the federal government could significantly improve matters. Then, through the "smart partnership" concept, internal auditors would be recognized as assisting in the fostering of better organizations. This is not an impossible task, as shown by one particular organization where the auditors are no longer perceived by their colleagues as "the police". Adding to the belief that the attitude towards auditors could be changed was the fact that the education levels of civil servants was improving, and with education comes the ability to appreciate a broader, positive context for the internal audit function.

A number of auditors interviewed think that by passing a federal law, instead of merely a treasury circular, the internal audit function in SLoGBs would be strengthened. However, in contrast, there was an audit head who thought that a circular issued by the appropriate state governments *would* be sufficient to improve general understanding of the duties of the internal audit departments, and would also lead to auditee cooperation, with consequential improvements in effectiveness. These latter ideas appear to have been formed by the individual's very bad experiences with top management and others in the organization who ignore the presence of the internal audit function in the organization. This is in spite of the fact that the audit function has been in place for several decades and has a significant staff complement. The audit head also stressed that such a circular, should it be issued, would need to require SLoGBs to strengthen their internal audit departments or units, not merely to set them up.

Other moves suggested during this study to strengthen the internal audit function in SLoGBs are related to audit personnel. First, federal government needs to change the SLoGBs habit of treating the position of audit head as a stepping stone to better positions in the organization. Failure to do so could result in appointees not taking their tasks seriously, the opposite of what is needed to ensure the recruitment and retention of staff committed to having a stronger internal audit function.

In addition, audit heads (and perhaps other key audit personnel) should be remunerated at a level which would command the respect of others within their organizations. From several interviews it emerged that one of the reasons for auditees ignoring audit reports is that, compared to other departmental heads, the audit heads earn so much less. Related to this, it emerged from another interview, there is the belief that audit personnel should be paid what private sector internal auditors are paid. With current low salary levels there is little motivation to be more productive. As it is, the situation means that internal audit in the public sector is used as a stepping stone to positions in the private sector.

Another crucial move in improving internal audit in SLoGBs would be for the relevant parties in the federal government to provide these organizations with sufficient job warrants to hire audit staff. While the quantity of job warrants is crucial, the quality of internal auditors recruited is no less so. Related to this, the federal government needs to provide them with appropriate training programs. As stated by a highly motivated audit head (the recipient of clean audit reports from the National Audit Department for many years), there is a need for regular, compulsory training programs for all audit personnel. It is hoped that the completion of the National Audit Academy at the end of 2004, attached to the National Audit Department (see the interview given by the Auditor-General to the *NST*, 18 October 2004) will enable this to occur. The aim of all these ideas is to match the capabilities of the internal audit function in SLoGBs with the size and the needs of their public organizations.

Last but certainly not least, it is crucial that the federal government clearly spells out the consequences of ignoring audit reports. One of the possible actions could be that reports regarding these cases are filed with appropriate authorities outside the organization. No mention of this type of reporting appeared in the 2004 Treasury Circular (that replaced the 1979 Treasury Circular). The 2004 Circular does, however, state that the presentation of the audit report is to be made at the organization's Financial Management and Account Committee meeting. It also says that the Treasury (whose director general issued the circular) is in charge of the task of evaluating the effectiveness of the internal audit units in the public sector.

One hopes that these and other actions will make a positive difference to the internal audit function. There are a number of other interesting issues raised in the 2004 Circular that are absent from the 1979 Circular. These include the following: the organizational head is now responsible for the employment of sufficient numbers of staff in the internal audit unit, and ensuring that they have access to appropriate training courses; heads of internal audit are required to file their annual working plan and internal audit annual reports (once approved by the organizational heads) with the Treasury no later than 31 January (for the plan) and 31 March of the following year (annual report); and finally all the internal audit units covered by the circular are required to become corporate members of the Internal Audit Institute of Malaysia, with the membership fees being paid by the government.

8 CONCLUSION AND RECOMMENDATIONS

In Malaysia, there is a continually increasing catalogue of organizational failures and mismanagement which shows how ineffective internal audit is in both the public and private sectors. This catalogue also signals the importance of internal audit to both sectors. This research paper highlights the various factors that inhibit the function from meeting its potential. Within the 35 SLoGBs that do have internal audit operations the two greatest inhibitors to efficient and effective operations are the lack of audit personnel and the audit personnel's lack of appropriate skills and competency for the tasks required of them. Less immediately obvious factors identified in this research include the rather difficult interaction between audit and non-audit personnel and between audit personnel and top management. It became obvious that so many internal audit operations in these SLoGBs still operate at a very simple, compliance-checking level, while for a significant minority independence of the auditors is a goal not yet in sight. This might be considered inevitable since the internal audit function for nearly half of the SLoGBs has only been around for just a few years. However, time alone does not improve matters: the effectiveness of internal audit functions in SLoGBs appears to be directly related to the management style of organizational heads found in SLoGBs, and their links, relationships and position in the social context in which the SLoGB is found.

In those extremely few cases where the internal audit function appears to be doing well, the one single determining factor appears to be the attitude and leadership qualities of the head of the SLoGBs. These organizational heads know the importance of the internal audit function to the organization, and therefore ensure that they employ enough audit personnel. They have also ensured that the heads of their audit operations are capable auditors, and that reports filed by internal auditors are acted upon appropriately. Their numbers are unfortunately very small.

Given this overview Malaysians may be assured that the internal audit function in very many SLoGBs will continue to be ineffective: "hidup segan, mati tak mahu" (no desire to live, [but then] no willpower to die). To be more exact, the internal audit departments may exist, but the overriding feature is the extreme shortage of staff and of auditing skills. This is complemented by incomplete or non-existent audit guidelines and audit reports that are ignored by everyone. In other words Malaysians may expect the status quo to remain unchanged.

The duty to correct the wrongs of internal audit in SLoGBs would appear, from interview data, to be largely in the hands of the federal government. Interviewees identified the need for a clear, comprehensive and authoritative statement of the role of internal auditors in all government organizations. The 2004 Treasury Circular appears to have been intended to do just that, but is really only one early step towards the establishment of the rightful place of internal audit in the nation's public sector.

Arising from this research it appears that federal government should consider conducting an in-depth study on internal audit in the government sector based on those conducted by Canada (Canadian Treasury Board Secretariat, 2000) and Malta (National Audit Office, 2000). In addition, such a research project should look at the appropriateness of introducing a process similar to the Taxation System Review Panel (announced during the Prime Minister's 2005 Budget speech) comprising members from both public and private sectors who are assisted by experts, and are required to convene public hearings.

The need for such a study was made clear by the International Monetary Fund's (IMF) Fiscal Affairs Department's 2002 study which identified various models for internal audit in the public sector (Diamond, 2002). In other words, such a proposed study should not only identify Malaysia's internal audit problems, but should also recommend appropriate model(s) for its public sector internal audit function.

In the present study, the assumption has been that the international audit standards produced by the IIA are appropriate for local consumption. But in his IMF Working Paper, Diamond (2002) argues that the international internal audit standards issued by the International Organization of Supreme Audit Institutions (INTOSAI) as well as those issued by the Institute of Internal Auditors may not be appropriate for many developing countries. Attempting to meet such "foreign" standards could introduce severe

problems since the economically advanced countries, in comparison to the developing ones, have a well-established culture of tolerance of auditors, and the will and funds to fully staff their audit departments. As Diamond, (2002, p. 8) says:

... the recognition that IA has evolved in a particular institutional, legal, and political environment, which varies markedly in different groups of countries, raises an important question of the wider applicability and practicality of these standards, especially for the government sector. Even within OECD countries, there is a wide disparity in the role assigned to the IA, as well as the way it is organized, which results in diverse IA practices. Such diversity is also reflected in other parts of the world where the IMF has offered advice in strengthening and reforming the IA.

Perhaps the suggested taxation system-style study should form part of a bigger study embracing internal *and* external audit in the public sector as a whole, while addressing the demands imposed by globalization, and for greater accountability and transparency from within the Malaysian society. Diamond (2002, p. 9) addresses this widening of the scope and context of the internal audit function:

IA cannot be expected to enforce good governance on its own without the existence of other workable controlling mechanisms to enforce accountability. In particular, it cannot substitute for external audit or compensate for a weak external audit system. Rather, the two systems should go hand-in-hand and complement each other. In many countries which suffer from a lack of personnel with the required skills to carry out IA, ways must be found to economize in the use of this scarce manpower both in terms of the design of the IA and restricting its functions so as not to dilute its impact.

At the recent MIER National Economic Outlook 2005 Conference in Kuala Lumpur on 7 December 2004 (NST, 8 December 2004) the Prime Minister stated: "The Government was open to constructive criticism and new ideas as it will be facing a number of challenges that may cloud its prospects in 2005." Interestingly, in the same conference, he mentioned that the government was deliberately sticking to building a national performance culture, supported by three levels of strategic development priorities. One of these concerned public sector performance. It is hoped that he was referring not just the federal bodies but also to those of state and local governments.

Supporting this view that *all* levels of the government must adopt a performance culture was economist Datuk Dr. Zainal Aznam Yusof of the Asian Strategic Leadership Institute (ASLI) in the recent interview with the newspaper *Mingguan Malaysia* (19 December 2004). Specifically, regarding the slowness of the nation's bureaucrats to respond to potential investors, he said:

Our bureaucrats have yet to understand the meaning of time for those who do business. We

have to shift our view of the delay in completing a bureaucratic task to cost incurred by businesses. I am not so sure as to whether our agencies and bureaucrats are looking at it that way. ...

...I may be a little critical but what I can see is that they do not understand it. That is why for so long I have argued that *the concept of Key Performance Indices (KPI) is expanded to all levels of the government down to the local governments. I think those at the low level of government (local authorities) are more involved in politics of the kind that are hardly visible to the eye, corruption and so on and so forth.* (Emphasis added.)

With federal government's efforts to improve internal audit in the public sector, it becomes obvious that internal audit is very important to public sector organizations. For many auditors interviewed this is as it should be. But this then would require that the current official importance given to the external audit function (particularly its audit reports) conducted by the National Audit Department, must now also be placed on the internal audit function.

One of the audit heads interviewed sees nothing wrong with that. After all, it is the internal auditor and not the external auditor who stays put inside the organization all year around. Nonetheless, this idea may not work in practice, simply because of the existence of the Auditor-General's Circular No. 1/2002 dated 14 May 2002. This Circular creates the impression that the auditors in the state and local governments are working for the National Audit Department. Such a view may be expected, when in Para 1.4 of Circular No. 1/2002 it is made clear that:

Presently nearly 80% of the posts at IAU are filled with officers from the National Audit Department, whether through secondment or through allocation of 'cadre' positions. Hence, the co-operative relationship between NAD and IAU is also important ... through such a relationship the management of NAD can evaluate the work performance of those officers for the purposes related to their career development.

Elsewhere in the Circular, under the heading "Mekanisma Perhubungan" (Relationship Mechanism), the different levels of interaction between the National Audit Department bosses and internal auditors are detailed and support the view that the latter are subservient to the former.

Therefore, the time is long overdue that the working relationship between auditors from the National Audit Department and those from internal audit departments or units is reviewed and redefined. Whilst both audit branches within government are supposed to work together closely, since both are concerned with internal control measures and public accountability issues, the relationship should not make one branch subservient to the other. Perhaps the division of responsibilities should be that the National Audit Department focuses solely on financial audit (thus financial management), while the internal

auditors focus on management audit, risk management and corporate governance issues, amongst other more recent additions to the internal audit sphere of influence.

In Parliament in April 2003 an MP raised similar idea (*NST*, 3 April 2003). It was his view that close cooperation between the Auditor-General and internal auditors of the various ministries and government departments would help expose cases of mismanagement in the government. The MP went on to say: "Annual audits by the Auditor-General may not reveal the more detailed and entrenched problems in a department. This is because those problems have been there for a long time and are difficult to detect. But internal auditors will have more insight into those discrepancies because they are there longer." (Husni Hanadzlah, MP for Tambun, quoted in *NST*, 3 April 2003).

It appears however that the separation of audit tasks is unlikely to occur. In other words, it is unlikely that the National Audit Department will ever focus exclusively on financial audits with the internal auditors' exclusive focus on management audits. This may be inferred from the interview given by the Auditor-General to the *NST* (18 October 2004) where he mentions the following:

Our Performance Audit will be the core business of the future. Here we see how projects and activities are implemented through observing three components – how projects are planned, their implementation, and who monitors the implementation ... As we go in and out of departments over the years, we expect more of them to be prudently managed. It is my aim to see that there is no need to highlight departments' financial management once they become strong, accountable and transparent. This will allow the department to focus mainly on auditing their performance. This is a realistic target. Now departments tend to repeat the same mistakes.

The above statements are unacceptable especially when so much more improvement is needed in the accounting arena of the state and local governments.

Azmi Setapa, a senior research fellow at the Malaysian Institute of Economic Research (MIER), touches on this issue when discussing bond financing for the local authorities (*NST*, 21 February 2004). (See also Azmi and Elayne, 2004.) He said that local authorities appear unable to secure bond financing because of "accounting practices and transparency issues". It seems that the current audited financial statements are not sufficient at all. Thus he says:

To enable rating agencies to execute their jobs successfully, they must be allowed to explore, examine and analyse all data related to local government activities. Thus, the whole transparency issue relating to the adequacy of accounting, auditing and disclosure standards will need to be addressed prior to the implementation of bond financing for the local governments.

Needless to say, this confirms the important role the accountants and auditors of the local governments play in helping these organizations to fulfill the information need of rating agencies. From these improved ratings local governments would have extended access to funds, enabling them to provide better services for their communities. Until now local governments have been financed through assessments and federal/state grants.

It appears fair to assume that for the foreseeable future the internal auditors in SLoGBs will maintain their subservient role to the National Audit Department's auditors. Those internal audit departments that are functioning well will continue to reduce the number of unfavorable SLoGB audit reports from the Auditor-General. This is already a reality. With the assistance of amongst others, the National Audit Department and the state government's finance department, one SLoGB set up its internal audit function and received a clean audit report from the Auditor-General the next financial year end. It must be noted, however, that in this particular case the SLoGB's audit head reported during this research interview that one of his tasks was to assist the National Audit Department in reducing repeatedly commented cases in the organization. In the light of decades of consistent criticism by the Auditor-General, the achievement of a clean external audit report should be reason enough for SLoGBs to celebrate in the short term.

The longer term tasks and goals for the audit function, however, go beyond the present concerns of implementing basic financial management (specifically, keeping of financial records, correctly preparing financial reports and offering appropriate training to employees). As an audit head stated, the future direction of internal auditors in the government sector should mean more authority and greater responsibility in helping their organizations to achieve their stated goals. (Illustrating the misuse of internal audit resources, many internal auditors are required to receive and investigate complaints from members of the public. This is in conflict with their real task of improving the work done by those within the organizations.)

Overall, this research highlights the need for an increase in resources allocated to the internal audit function in the Malaysian public sector. In an era where globalization, accountability and transparency are considered points of reference in just about every business and public sector activity, the challenge is to uproot old ways and to establish viable and appropriate new ones. Failure to implement the necessary changes will perpetuate the internal audit function's already negative reputation of being interested only in finding fault with the organization, and this is of little real benefit to anyone. Without strong effort to upgrade the internal audit function the country will not achieve its potential in the face of more competitive foreign businesses .

That glimmer of hope mentioned above appears to be an unsustainable anomaly at present. The politics of accountability theory (Schwartz and Sulitzeanu-

Kenan, 2002) plus the nation's large power distance (Hofstede, 1991) combine with the fact that most aspects of Malaysian life lack transparency and public accountability (Azham, 1994, 1999) to suggest that it is highly improbable that anyone in internal audit would be willing or able to make and sustain the required changes. As far as internal audit in SLoGBs has a future, it appears to be as bleak as its present. Those changes that have been reported have not been sustained, and the recent prevention of the Auditor-General's annual reports on state governments and federal government agencies from being tabled in the Parliament (NST, 14 December 2004) effectively halted any hope for improvement in the internal audit function in Malaysia.

These Auditor-General reports allegedly contained proof that some states were effectively bankrupt and would have given added weight to comments made by the leader of the opposition, Lim Kit Siang, and the Auditor-General. The Auditor General, in an interview in the *New Sunday Times* (NST 18 October 2004) said: "... Many States are in dire straits as additional revenues are not forthcoming ... I can say that a few are on the brink of bankruptcy ..."

9 LIMITATIONS OF THE STUDY

There were at least four significant challenges faced by the study. The first concerned the absence of a locally generated set of standards for the practice of internal auditing. This necessitated the use of foreign benchmarks in the form of the SPPIA (and similar documents) against which to study internal auditing in state and local government departments. As Diamond (2002) mentions, the question of relevance of international standards to Malaysia has not been finally established. However, it is interesting to note that these very same SPPIA were (re)issued by the Institute Internal Auditors Malaysia in 2002 as guidance for internal audit departments in the nation's listed companies.

A second possible weakness of this study concerned the collection of data through face-to-face and phone interviews with civil servants. The key concern was the perceived sensitivity of the issues addressed in this research. Given the structure of the departments, and the nature of Malaysian society, it was always possible that interviewees would "soften" their responses in order to protect themselves from the consequences of a too negative (accurate) portrayal of the state of internal audit in the country. In the attempt to gain fuller co-operation, interviewees were assured, both in the letter inviting participation and at the start of the face-to-face interviews, that confidentiality would be assured for every section of the interview; that they should feel free to describe matters in their own words, and that the open-ended, semi-structured section of the face-to-face interview would only be recorded if they gave specific permission for this. In cases where they did give permission to tape, they were also allowed to ask the interviewer to stop the taping at any point. Finally, they were also assured of anonymity: that in any published results it would not be possible to identify

either the person or the organisation, unless specific permission had been obtained beforehand.

The third possible weakness of the study involves the possibility that participants in the study might not be telling the truth. Van Maanen (1979) discusses three reasons for deception by interviewees being interviewed at their places of work: maintaining or enhancing appearance; ignorance, and unsubstantiated assumptions. Interviewers however have a number of techniques at their disposal to identify the reasons for omitting, selecting or distorting data and for attempting to deceive the interviewer (not to mention deceiving themselves). Douglas (1976), and Miles and Huberman (1994) discuss various techniques open to an interviewer: sharing knowledge of "what's going on" (for example quoting earlier media reports) and seeing whether the respondent concurs; summarising a state of affairs and then asking the interviewees to deny it; continuous probing during the interview sessions; and triangulation of views from several different sources.

The final possible weakness of the study involves the writing of reports *after* each phone and face-to-face interview. During these interviews, little note-taking was undertaken, to ensure full concentration on the matters being discussed. But within the next twelve hours the interviewer had to tape record a summary and analysis of what had been discussed. At a later stage a fuller report, complete with quotes where necessary, was prepared for each interview. While the objective was to retain as much of the essence of the original data as possible, this type of data gathering is prone to the loss of data through the act of producing a summary.

10 FURTHER STUDY

Since internal audit is such an important monitoring function in an organization, it would be highly informative if similar studies, using more or less the same questionnaire and approach, were to be conducted for other organizations in the country. Perhaps by doing so, problems and challenges faced by the audit function as a whole, would be identified, thus enabling corrective efforts to be undertaken similar to those now being attempted for the SLoGBs in Peninsular Malaysia. Other organizations which might be studied include federal government ministries, departments and agencies; federal government's statutory bodies and associated companies; companies listed on Bursa Malaysia, and the nation's cooperatives.

Within the last year few years, the head of the research team together with others have in fact embarked on two studies of the internal audit function in bodies and companies associated with the federal government. The same approach of in-depth interview was used. The second study on internal audit in the federal ministries and departments (plus six statutory bodies) has already been completed, while for the third one, covering the rest of the statutory bodies and GLCs located in Klang Valley, the data collection process is still on going. The former study is supported by the university grant, while the latter comes under IRPA. A total of just over RM 100,000 of public funds will have been spent in three studies of internal audit in Malaysia's public sector by the middle of 2007.

In the current and ongoing research projects the results would have been strengthened if the senior officials and departmental heads had been given the opportunity to participate. Their views, when compared with those of the internal auditors (who almost always perceive themselves as the victims), would have given additional insight into the challenges facing internal audit departments. In fact, the heads of the SLoGBs whose internal auditors were interviewed have been invited to respond to this research report.

Finally, it would also be most interesting to research and compare the state of internal auditing in the public sectors in Sabah and Sarawak particularly since the Auditor-General recently identified Sarawak as one of the well-managed states (*NST*, 18 October 2004), while Sabah is one of the seven states in the federation categorized as "almost bankrupt". As reported by John Teo in his column (*NST*, 11 December 2004), of all the states in the federation, Sarawak also has the healthiest financial balance sheet with surplus reserves in excess of RM3 billion. Hence, it is not surprising to find that it is the only state in Malaysia that has been given credit rating by an international credit-rating agency, thus making it possible for Sarawak to tap the international financial markets for funds to develop the state economy.

Such a study would uncover the attributes of a well-run internal audit function in the state, and identify its contribution to the state's stellar financial performance. The findings could also be compared with those for Peninsular state and local governments where in most cases the internal audit function is at "infancy stage". Finally, Sarawak's experience may be used as the local bench mark for future studies of the functioning of internal audit in Malaysia's SLoGBs.

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APPENDIX A

SOURCES REFERRED TO IN BUILDING UP THE QUESTIONNAIRE

There include those mentioned in the literature review section of this proposal: Brierley et al. (2001), Schwartz and Sulitzeanu-Kenan (2002), the two overseas studies by Ernst & Young, the MIA studies and the Auditor-General of Malta's report. Others that are crucial in preparing the questionnaire but have not been referred to earlier are Liu et al. (1997), Gavin et al. (1995), Cooper et al. (1994) and Vinten (1991). Specific aspects of the questionnaire have also found assistance from the following works: Palmer (1996), Ziegenfuss (1995) and Chan (1995).

In addition, materials found on the websites of The University of Texas's Southwestern Medical Center at Dallas, Texas State Auditor's Office and the United States Institute of Internal Auditors' Global Auditing Information Network (GAIN) have been of tremendous help. In particular, the main component of the questionnaire - section B - was developed based on the 2002 version of the Standards for the Professional Practice of Internal Auditing (SPPIA) issued by the Institute of Internal Auditors of the United States (IIA: 2003b, 2003c).

Basing the questionnaire on the SPPIA is appropriate since, as Whittington and Pany (2001, p. 788) state: "To maintain consistently high-quality services across the internal auditing profession, the IIA has issued the

Standards for the Professional Practice of Internal Auditing. These standards ... set forth the criteria by which the operations of an internal auditing department should be evaluated and measured." This very view parallels the position taken by the Board of Directors of the IIA in the "Foreword" to the 1978 edition of the SPPIA:

The *Standards for the Professional Practice of Internal Auditing* are the result of nearly three years of efforts ... These standards are meant to serve the entire profession in all types of business, in various levels of government, and in all other organizations where internal auditors are found. The term "standards," as used in this document, means the criteria by which the operations of an internal auditing department are evaluated and measured. They are intended to represent the practice of internal auditing as it should be, as judged and adopted by the Board of Directors of The Institute.

Similar remarks may also be found in the "Guidance Overview" of the IIA's Professional Practices Framework, released in 1999 and which comprises a new version of the SPPIA (IIA, 2003d). Interestingly, the "Introduction" of the new version of the SPPIA states unequivocally that the purposes of the standards (IIA, 2003a) are to:

- Delineate basic principles that represent the practice of internal auditing as it should be.
- Provide a framework for performing and promoting a broad range of value-added internal audit activities.
- Establish the basis for the measurement of internal audit performance.
- Foster improved organizational processes and operations.

To mention just a few works, Ridley (1994), Crockett and Albin (1995), Montondou (1995), Ridley and Chambers (1998) and Moeller and Witt (1999) have also stressed that for internal auditing to be considered a value added activity it is necessary that internal auditors and other relevant parties comply with the SPPIA.

In its 2002 version, the SPPIA are broken into three major categories - Attribute Standards, Performance Standards, and Implementation Standards - that cover areas such as the presence of an audit charter, the qualities of independence and proficiency of internal auditors, and the good conduct of internal audit activities. Because of their broad scope and clear definitions, the SPPIA were utilized as the "benchmarks" against which the actual operation of internal audit departments or units in the Malaysian government organizations were studied.

Besides SPPIA, the Canadian Government Internal Audit Policy and Standards (Treasury Board of Canada Secretariat, 2002) document was referred to extensively in preparing the questions in Section B. While there are many similarities with the Attribute Standards and Performance Standards that form important sections of the IIA's SPPIA, one important difference concerns the reporting aspect whereby the Canadian Standards demand public disclosure (in accordance with both legislation and government policy) of not only the audit findings and recommendations but also a time phased corrective action plan on the part of the management which must be periodically updated (IIA, 2003e).

APPENDIX B
LIST OF STATE & LOCAL GOVERNMENTS (FACE-TO-FACE INTERVIEWS)

STATES	POSITION HELD BY INTERVIEWEE	UNIT/ DEPARTMENT
JOHOR		
1. Majlis Bandaraya Johor Bahru	Head of Internal Audit	Unit
2. Setiausaha Kerajaan Negeri Johor	Head of Internal Audit	Unit
MELAKA		
1. Majlis Bandaraya Melaka Bersejarah	Internal Auditor, Internal Audit Assistant	Unit
2. Perbadanan Air Melaka	Internal Auditor	Department
3. Perbadanan Kemajuan Negeri Melaka	Manager of Internal Audit and System Quality	Unit
4. Setiausaha Kerajaan Negeri Melaka	Accountant, Internal Audit Assistants (2)	Department
SELANGOR		
1. Majlis Perbandaran Petaling Jaya	Head of Internal Audit, Internal Auditor	Unit
2. Majlis Perbandaran Selayang	Acting Head of Internal Audit / Internal Audit Assistant (Phone Interview)	Unit
3. Majlis Perbandaran Subang Jaya	Internal Auditor	Unit
4. Majlis Perbandaran Kelang	Head of Internal Audit	Unit
5. Majlis Bandaraya Shah Alam	Head of Internal Audit, Internal Audit Assistants (2)	Unit
6. Majlis Perbandaran Ampang Jaya	Internal Audit Assistant (Phone Interview)	Department
7. Perbadanan Kemajuan Negeri Selangor	Head of Internal Audit	Unit
8. Setiausaha Kerajaan Negeri Selangor	Head of Internal Audit and Public Complaints / Special Officer to the State Secretary	Department
9. Majlis Agama Islam Selangor	Head of Internal Audit	Unit
PAHANG		
1. Majlis Perbandaran Kuantan	Head of Internal Audit	Department
2. Perbadanan Kemajuan Negeri Pahang	Senior Officer of Internal Audit	Unit
3. Setiausaha Kerajaan Negeri Pahang	Head of Internal Audit, Audit Clerk	Unit
4. Lembaga Kemajuan Perusahaan Pertanian Pahang	Manager of Internal Audit, Internal Auditors (5)	Unit
TERENGGANU		
1. Perbadanan Memajukan Iktisad Negeri Terengganu	Manager of Internal Audit	Unit
2. Setiausaha Kerajaan Negeri Terengganu	Head of Internal Audit	Unit
KELANTAN		
1. Majlis Perbandaran Kota Bharu	Head of Internal Audit	Department
2. Perbadanan Kemajuan Iktisad Negeri Kelantan	Manager of Internal Audit and Naziran	Department
3. Setiausaha Kerajaan Negeri Kelantan	Head of Internal Audit	Unit
PERAK		
1. Majlis Bandaraya Ipoh	Internal Auditor	Department
2. Majlis Perbandaran Taiping	Head of Internal Audit	Unit
3. Perbadanan Kemajuan Negeri Perak	Manager of Internal Audit	Unit
4. Lembaga Air Perak	Head of Internal Audit (Answered Parts A & B), Audit Assistant (C & D)	Department
5. Setiausaha Kerajaan Negeri Perak	Head of Internal Audit	Unit
PULAU PINANG		
1. Majlis Perbandaran Pulau Pinang	Head of Internal Audit	Unit
2. Majlis Perbandaran Seberang Prai	Internal Auditor	Unit
3. Perbadanan Pembangunan Pulau Pinang	Internal Auditor, Internal Audit Assistant	Unit
4. Setiausaha Kerajaan Negeri Pulau Pinang	Assistant to the Head of Internal Audit	Unit
KEDAH		
1. Perbadanan Kemajuan Ekonomi Kedah	Head of Internal Audit	Unit
2. Setiausaha Kerajaan Negeri Kedah	Head of Internal Audit /Special Officer to the State Secretary (Answered Parts D & C), Internal Auditor (A & B)	Unit

APPENDIX C

LIST OF STATE & LOCAL GOVERNMENTS (PHONE INTERVIEWS)

PERLIS

1. Pejabat SUK Perlis
2. Perbadanan Kemajuan Ekonomi Negeri Perlis
3. Yayasan Islam Negeri Perlis
4. Majlis Perbandaran Kangar

KEDAH

1. Majlis Bandaraya Alor Setar
2. Majlis Perbandaran Sungai Petani
3. Majlis Daerah Yan
4. Majlis Daerah Sik

5. Majlis Perbandaran Kulim
6. Majlis Daerah Kubang Pasu
7. Majlis Daerah Padang Terap
8. Majlis Perbandaran Langkawi

PULAU PINANG

1. Majlis Sukan Negeri Pulau Pinang
2. Perbadanan Perpustakaan Awam Negeri Pulau Pinang

SELANGOR

1. Majlis Daerah Sepang
2. Majlis Daerah Kuala Selangor
3. Majlis Daerah Hulu Selangor
4. Majlis Perbandaran Kajang
5. Majlis Daerah Kuala Langat

NEGERI SEMBILAN

1. Pejabat SUK Negeri Sembilan
2. Perbadanan Kemajuan Negeri Sembilan
3. Yayasan Negeri Sembilan

MALACCA

1. Majlis Daerah Jasin
2. Yayasan Melaka
3. Perbadanan Perpustakaan Awam Melaka
4. Perbadanan Kemajuan Tanah Adat Melaka
5. Majlis Perbandaran Alor Gajah
6. Kolej Teknologi Islam Melaka
7. Majlis Sukan Negeri Melaka

PAHANG

1. Yayasan Pahang
2. Perbadanan Kemajuan Bukit Fraser
3. Perbadanan Stadium Darul Makmur
4. Majlis Daerah Rompin

5. Majlis Daerah Maran
6. Majlis Daerah Raub
7. Majlis Daerah Bentong
8. Majlis Daerah Temerloh
9. Majlis Daerah Jerantut

TERENGGANU

1. Majlis Daerah Marang
2. Majlis Daerah Besut
3. Majlis Perbandaran Kemaman
4. Majlis Daerah Setiu
5. Majlis Daerah Dungun
6. Majlis Daerah Hulu Terengganu

KELANTAN

1. Majlis Daerah Machang
2. Majlis Daerah Pasir Puteh
3. Majlis Daerah Gua Musang
4. Majlis Daerah Jeli
5. Majlis Daerah Kuala Krai
6. Majlis Daerah Tanah Merah
7. Majlis Agama Islam Kelantan
8. Perbadanan Perpustakaan Awam

