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Internal Audit Roles and its Challenges in Public Sector Governance

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Abstract

The internal audit function plays a crucial role in public sector governance by providing independent assurance, risk management, and effective governance practices. However, this function faces various challenges that need to be addressed to ensure its effectiveness. This paper explores the challenges faced by the internal audit function in public sector governance, including issues such as independence, resource limitations, complex regulatory environments, political influence, and resistance to change. Additionally, challenges related to skills and expertise, data management, stakeholder expectations, and organizational culture are discussed. To overcome these challenges, several recommendations are provided, including enhancing independence, allocating sufficient resources, promoting continuous professional development, strengthening regulatory awareness, fostering a culture of accountability, enhancing collaboration, promoting awareness and understanding, embracing technology, strengthening communication, and monitoring the implementation of recommendations. By implementing these recommendations, public sector organizations can enhance the effectiveness of their internal audit function, leading to improved governance, risk management, and accountability in the public sector.

Keywords: Internal Audit, Public Sector Governance, Challenges, Independence.

INTRODUCTION

The roots of internal audit can be found in ancient civilizations such as ancient Egypt and Mesopotamia, where scribes were responsible for recording and auditing transactions. The Code of Hammurabi, dating back to 2100 BC, included provisions for the auditing of financial transactions. In the 19th century, the Industrial Revolution brought about significant changes in business practices and the need for financial accountability. The concept of financial auditing emerged during this period, focusing on verifying financial records and ensuring accuracy. The profession of external auditor began to take shape. The modern era of internal audit began in the United States in 1941 with the establishment of the Institute of Internal Auditors (IIA). The IIA was founded to promote the profession of internal auditing and provide guidance and professional standards. The IIA has played a crucial role in the development and advancement of internal audit practices globally. Internal audit gained prominence in the mid-20th century as organizations recognized the importance of effective internal controls, risk management, and governance (Sawyer, 2002; Institute of Internal Auditors, 2021; Warren & Shelton, 2010; DeZoort & Harrison, 2016). The role of internal auditors expanded beyond financial auditing to include operational audits, compliance audits, and evaluating internal processes. To provide consistent guidelines and professional standards for internal auditors, the IIA developed the International Standards for the Professional Practice of Internal Auditing (Standards). These standards, first issued in 1978, have been periodically updated to reflect the evolving nature of the profession and provide a framework for internal audit activities. In recent years, the role of internal audit has continued to evolve due to advancements in technology, changes in business environments, and increased focus on risk management.

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Internal auditors are now expected to provide strategic insights, evaluate emerging risks, and assess the effectiveness of internal controls and governance structures (Sawyer, 2002; Institute of Internal Auditors, 2021; Warren & Shelton, 2010; DeZoort & Harrison, 2016).

The internal audit function started to emerge in the early 20th century as a response to the need for independent oversight of business operations. It was primarily focused on financial audits and fraud prevention within organizations. The establishment of the Institute of Internal Auditors (IIA) in the United States marked a significant milestone for the internal audit profession. The IIA played a crucial role in promoting professional standards and ethics, as well as providing guidance and support to internal auditors worldwide. The focus of internal audits expanded beyond financial audits to include operational audits, compliance audits, and risk management (Cabrera & McGrath, 2014; Martin, 2013; Silverstone & Sheetz, 2009). This shift was influenced by the need to address emerging business risks and the increasing complexity of organizational processes. The advancement of information technology and the increasing reliance on data analytics transformed the internal audit function. Auditors started leveraging technology-driven audit techniques, enhancing the effectiveness and efficiency of their audits (Cabrera & McGrath, 2014; Martin, 2013; Silverstone & Sheetz, 2009).

Internal audits in Nigeria can be traced back to the colonial era when companies and government agencies started appointing auditors to ensure financial accountability and compliance. The primary focus was on financial audits to detect fraud and misappropriation of funds. After Nigeria gained independence in 1960, the role and significance of internal audits expanded. Internal auditors played a vital role in promoting transparency, accountability, and good governance practices in both the public and private sectors (Okolie & Anao, 2019 ; Ogundele & Fatokun, 2017; Olabode & Okolie, 2019; Tunde-Ayinmode & Okoh, 2019). Over the years, regulatory bodies such as the Financial Reporting Council of Nigeria (FRCN), the Securities and Exchange Commission (SEC), and the Central Bank of Nigeria (CBN) have introduced regulations and guidelines to enhance the effectiveness and professionalism of internal audits in Nigeria. The Institute of Internal Auditors Nigeria (IIAN) is the professional body responsible for promoting the practice of internal auditing in Nigeria. IIAN provides training, certification, and guidance to internal auditors, contributing to the professionalization of the field (Okolie & Anao, 2019 ; Ogundele & Fatokun, 2017; Olabode & Okolie, 2019; Tunde-Ayinmode & Okoh,2019).

Organizations are subject to a growing number of regulations and compliance standards. Internal auditors need to stay knowledgeable about these requirements and ensure that the organization's processes align with the relevant regulatory frameworks. Internal auditors often face the challenge of striking the right balance between providing assurance on the effectiveness of internal controls and offering advisory services to improve operational efficiency and effectiveness (Moeller & Embrechts, 2018; Beasley, Branson, & Hancock, 2019; Alzoubi & Mahenthiran, 2018). Ensuring independence and objectivity while providing valuable insights can be challenging. The availability of vast amounts of data presents both opportunities and challenges for internal auditors. Effectively leveraging data analytics tools and techniques, while managing the volume and complexity of data, can be a challenge. Internal auditors need to effectively communicate their findings and recommendations to management and other stakeholders. Building strong relationships and collaboration across different departments and levels of the organization can be a challenge (Moeller & Embrechts, 2018; Beasley, Branson, & Hancock, 2019; Alzoubi & Mahenthiran, 2018; Osagioduwa, 2022). Building upon the research in Nigeria's public sector governance, we aim to explore how the internal audit functions as well as the challenges faced in public sector governance.

Conceptual View of Internal Audit

An internal audit is an independent and objective assurance and consulting activity intended to enhance an organization's operations and provide value (Institute of Internal Auditors, 2013). It employs a systematic and disciplined approach to assess and improve the effectiveness of risk management, control, and governance processes (Chartered Institute of Internal Auditors, 2017). The objective of an internal audit is to assist organizations in accomplishing their goals by evaluating activities and internal controls, ensuring the efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations (Olabode & Okolie, 2019). Serving as an independent appraisal function within an organization, internal audit examines and evaluates activities to support members in effectively discharging their responsibilities (The Chartered Institute of Management Accountants, 2005).

By providing independent assurance and consulting services, internal audit contributes to the enhancement of an organization's operations (Deloitte, 2020). It systematically evaluates and monitors risk management, control, and governance processes to assist organizations in achieving their objectives (The Institute of Internal Auditors Canada, 2016). Internal audit plays a vital role in objectively evaluating an organization's risk management, control, and governance processes, providing management and the board with independent assessments of operational effectiveness and efficiency (Chartered Professional Accountants of Canada, 2015).

Furthermore, internal audit acts as an independent, objective assurance and consulting activity aimed at improving an organization's operations and adding value (The Institute of Internal Auditors Australia, 2020). By systematically evaluating and enhancing risk management, control, and governance processes, internal audit helps organizations ensure effective management practices (The Institute of Internal Auditors Malaysia, 2021).

Public Sector Governance Concept

Public sector governance encompasses the structures, processes, and systems through which public sector organizations are directed, controlled, and held accountable in the pursuit of public interest (OECD, 2005). It involves the mechanisms and practices that ensure transparency, accountability, and ethical conduct in the management of public resources and the delivery of public services (UNDP, 2007). Public sector governance encompasses the formulation and implementation of policies, strategies, and practices to achieve public sector objectives, promote public value, and ensure the well-being of citizens (Grindle, 2010). It involves the effective and efficient management of public institutions, decision-making, and service delivery through the establishment of mechanisms and relationships (Osborne, 2010). Public sector governance governs the relationships between government, citizens, civil society organizations, and other stakeholders, aiming to promote public interest and public value (Rhodes, 2007).

It refers to the principles, policies, and practices that guide the conduct of public officials, ensure integrity, and foster public trust in government (World Bank, 2017). Public sector governance includes the principles, policies, and practices that guide the relationship between the government and citizens, ensuring transparency, accountability, and citizen engagement (United Nations, 2009). It encompasses the mechanisms and processes that enable public sector organizations to make and implement decisions, manage resources, and deliver services in a transparent, accountable, and participatory manner (World Bank, 2017). Public sector governance is based on the principles, policies, and practices that guide effective and equitable service delivery, participation, and citizen engagement (United Nations, 2009). It involves the mechanisms and structures that promote transparency, accountability, and the rule of law in the management of public affairs and the delivery of public services (Asian Development Bank, 2011).

In summary, public-sector governance encompasses the structures, mechanisms, and principles that guide the management, decision-making, and accountability in public sector organizations (IMF, 2014). It aims to ensure transparency, accountability, effective resource utilization, and the provision of quality public services for the benefit of the public (IMF, 2014).

Internal Audit Functions

Internal audit functions encompass a wide spectrum of crucial roles within an organization. Firstly, they provide independent and objective assurance to management and stakeholders concerning the effectiveness of internal controls and the overall governance framework (Institute of Internal Auditors, 2013). Additionally, internal audit plays a pivotal role in identifying, assessing, and monitoring risks, aiding management in making informed decisions and implementing strategies for risk mitigation. Another significant function involves ensuring compliance by verifying and assessing adherence to laws, regulations, policies, and procedures (Knechel, 2016). Furthermore, internal audit evaluates operational processes to enhance efficiency, reduce costs, and recommend improvements. In the realm of fraud prevention and detection, it assesses controls, conducts investigations, and implements measures to prevent fraudulent activities.

Moreover, internal audit assesses governance effectiveness, including board oversight and ethical standards, and reviews financial reporting processes for accuracy and compliance. It also evaluates information technology systems and security measures, ensuring adequacy and integrity (Halper, 2017). Additionally, it provides quality assurance, aids in fraud risk management, engages in continuous monitoring, and assesses adherence to ethics, code of conduct, and corporate policies. Internal audit identifies opportunities for business process improvement, conducts due diligence reviews, and communicates findings to foster effective communication and transparency among stakeholders.

Theoretical framework

One suitable theory that can be applied to the challenges faced by the internal audit function in public sector governance is the Agency Theory. The Agency Theory focuses on the relationship between the principal (the public sector organization) and the agent (the internal auditors). It examines the potential conflicts of interest that may arise due to the separation of ownership and control within an organization (Jensen & Meckling, 1976; Eisenhardt, 1989). According to the Agency Theory, the internal audit function serves as a mechanism to mitigate the agency problem by providing independent assurance and monitoring the actions of management. It aims to align the interests of the principal and the agent, ensuring that the agent acts in the best interests of the organization (Jensen & Meckling, 1976; Eisenhardt, 1989).

Internal Audit and Its Challenges in Public Sector Governance

Researchers (Swasti & Windawaty, 2017; Kporsu, & Sam, 2021; Elmagrhi, Hussein & Aris, 2019; Caruana & Morris, 2017) have highlighted numerous challenges faced by internal audit functions in the public sector's governance and practices. Certainly, the challenges confronting the internal audit function within the public sector are multifaceted and impactful. Independence remains a primary struggle, as the function contends with maintaining autonomy from management and stakeholders, risking compromised assessments due to perceived biases. Limited resources pose a significant hurdle, from inadequate budgets and technology to understaffing, hindering the effectiveness and comprehensiveness of audits. The ever-evolving regulatory landscape adds complexity, demanding constant vigilance to ensure audits align with the latest standards.

Political influences further challenge independence, as interference can impede the objectivity of audit activities. Resistance to change within organizational cultures impedes the implementation of recommended improvements. Moreover, limited access to timely information and a lack of awareness about the value of internal audits add layers of difficulty, impacting the thoroughness and effectiveness of assessments. Balancing diverse stakeholder expectations while maintaining integrity remains an ongoing struggle, as does the continual need to develop and apply evolving skill sets to address complex and evolving risks and governance issues.

The landscape within which internal auditors operate is marked by resistance to their recommendations, limited awareness of their value, inadequate training opportunities, and the immense task of managing vast amounts of data. Complex organizational structures, political instability, and insufficient authority also compound the difficulties. Moreover, the high levels of scrutiny and accountability in the public sector continually test internal auditors' ability to meet expectations while safeguarding their independence and objectivity.

Internal Audit and Public Sector Governance

The internal audit function plays a critical role in public sector governance by providing independent assurance, risk management, and effective governance practices (Scott & Sarganis, 2018). It helps ensure transparency, accountability, and the efficient use of public resources (Vintar & Košir, 2013). However, the internal audit function also faces several challenges in fulfilling its objectives within the public sector governance context. These challenges can be seen as variables that affect the effectiveness of the internal audit function. The level of independence, availability of resources, complexity of regulatory environments, political influence, resistance to change, skills and expertise, data management, stakeholder expectations, organizational culture, and the implementation of audit recommendations are all factors that impact the functioning of internal audit in public sector governance (Alshammari, 2019; Mazengia, 2015).

Limited independence may hinder the objectivity and effectiveness of internal audits, while inadequate resources can constrain the scope and depth of audit activities (Brusca & Montesinos, 2014). Complex regulatory environments may create challenges in navigating compliance requirements, and political influence can compromise the independence and objectivity of internal auditors (Auriol & Blanc, 2009). Resistance to change within the public sector can impede the implementation of audit recommendations, reducing the overall effectiveness of governance practices (Scott & Sarganis, 2018). Insufficient skills and expertise may limit the ability of internal auditors to address emerging risks and governance issues (Mazengia, 2015). Inadequate data management practices can hinder the ability to perform thorough and data-driven audits, while stakeholder expectations must be managed to ensure the value and impact of the internal audit function (Polonijo, 2019). The organizational culture within the public sector plays a crucial role in supporting or hindering the internal audit function (Brusca & Montesinos, 2014). Finally, the implementation of audit recommendations is critical to strengthening governance practices (Alshammari, 2019).

Addressing these challenges is vital for the internal audit function to effectively contribute to the overall governance framework, ensuring transparency, accountability, and the responsible use of public resources (Vintar & Košir, 2013). By recognizing and addressing these variables, public sector organizations can strengthen their internal audit function and enhance public sector governance.

Internal audit serves as a critical component of public sector governance by providing independent and objective assessments of risk management, control systems, and governance processes (Vintar & Košir, 2013). It helps ensure transparency, accountability, and the responsible use of public resources (Scott & Sarganis, 2018). Through its activities, internal audit contributes to improving the effectiveness and efficiency of public sector operations and the overall governance framework.

One key aspect of the relationship between internal audit and public sector governance is the promotion of good governance practices. Internal audit functions as a mechanism to monitor and evaluate the adherence to governance principles and standards within public sector organizations (Scott & Sarganis, 2018). By assessing the effectiveness of governance structures, processes, and controls, internal audit assists in identifying areas for improvement and ensuring compliance with relevant laws, regulations, and policies.

Furthermore, internal audit plays a crucial role in identifying and managing risks within the public sector. Through risk assessments and evaluations of control systems, internal auditors help identify vulnerabilities, potential fraud, and weaknesses in internal controls (Vintar & Košir, 2013). By doing so, internal audit contributes to the prevention and detection of financial mismanagement, corruption, and other forms of misconduct, thereby enhancing accountability and integrity within public sector organizations.

The relationship between internal audit and public sector governance also extends to the provision of assurance to stakeholders. Internal auditors provide independent and objective assessments of the adequacy and effectiveness of risk management practices, control systems, and governance processes (Scott & Sarganis, 2018). This assurance helps build trust and confidence among stakeholders, including citizens, government officials, oversight bodies, and external auditors.

To strengthen the relationship between internal audit and public sector governance, it is crucial to address the challenges that the internal audit function faces. These challenges include maintaining independence, allocating sufficient resources, navigating complex regulatory environments, managing political influence, addressing resistance to change, ensuring adequate skills and expertise, improving data management practices, managing stakeholder expectations, fostering a supportive organizational culture, and implementing audit recommendations (Alshammari, 2019; Mazengia, 2015). By effectively addressing these challenges, public sector organizations can enhance the effectiveness and value of the internal audit function in supporting good governance, risk management, and accountability.

Mwanza and kaira (2022) examined the effectiveness of internal auditing in Zambia's public sector. They used primary and secondary data from 172 randomly selected sample. From the analysis, the results showed that top management support and organisational independence significantly affect the performance of internal audit effectiveness. Okee and Fred (2021) reviewed the challenges of internal audit function in Nigeria public institutions. They employed content analysis and extensive literature review and reported that a number of obstacles, including administrative, political, and compliance issues, have made internal audit functions in Nigerian institutions ineffective. As a result, the public sector has been less able to deliver services effectively and efficiently.

The study also conclude that the public sector will continue to struggle with resource management and better service delivery as a result of these issues, as well as faulty internal audit function structure that hinders internal auditors' independence in carrying out their duties, issues with the executive's domineering presence, lack of continuity of programs due to changes in government or governance, and senior management team of the entities' noncompliance with internal control measures. Similarly, Egbunike and Egbunike (2017) carried out an empirical examination of challenges faced by internal auditors in public sector audit of south-eastern Nigeria. The ministries, parastatals, and state government offices in Anambra, state, comprised the study's population. Using the descriptive survey research design, the data was analysed and the study concludes that while internal auditors of public sector entities face challenges related to independence and adhering to established rules and regulations regarding public fund management, improper segregation of duties does not present a challenge to them.

Dele (2016) conducted research on the efficacy of internal auditing as a tool for internal and financial control in Nigerian local governments. The study collected data via questionnaires and analyzed the results using basic statistical methods including frequency distribution and percentages. The study's conclusions show that the local government understudied was beset by issues such as understaffing, insufficient internal control, lack of independence, poor remuneration, and a shortage of skilled personnel. The study came to the conclusion that internal audit at the local government should be free from management and political influence, and that auditors should be well compensated to enable them to do their jobs well. Adedokun and Unam (2016) examined the impact of internal audit function on the accountability of Oyo state public sector in south western Nigeria. The primary data obtained was analysed using Pearson correlation and multiple regression analysis. From the findings, internal audit function had a significant impact on public sector accountability. Also, Kpurugbara, Akpos, Nwiduuduu, and Tams-Wariboko (2016) investigated auditing processes and procedures in the

Nigerian local government service system, concentrating on a few chosen LGAs in the Rivers state. The study specifically determined the effects of auditor independence and the auditor recruitment procedure on public auditor performance in Nigerian local government areas. 15 LGAs were selected and a sample of 265 was drawn from the 781 population. With the help of SPSS, the collected data was analyzed using the Kruskal Wallis test and the hypotheses test findings showed that the independence of auditors affects the caliber of the appointment procedures and the audit report also influences how well public performers perform auditors for the sector.

Methodology

Utilizing the extant research on internal audit functions and challenges on the public sector, the literature review approach was adopted for this study. As a result, the study was able to get insight into the calibre of research on the roles of internal audit and their challenges as it affects public sector governance in Nigeria.

Findings

The study shows that the role of internal audit is paramount to the efficacy of public sector governance. Also, the challenges faced by the internal audit of public sector in Nigeria are set-backs that hinder their operations to its fullest optimum. However, these challenges are surmountable and one of the ways of doing that is to strengthen the internal control system of the public sector.

Conclusion and Recommendations

In conclusion, the internal audit function in public sector governance plays a critical role in ensuring accountability, risk management, and effective governance practices. However, it also faces several challenges that need to be addressed to enhance its effectiveness and value.

The challenges identified include issues such as maintaining independence, limited resources, navigating complex regulatory environments, political influence, and resistance to change. Additionally, challenges related to skills and expertise, data management, stakeholder expectations, and organizational culture can hinder the internal audit function's ability to fulfil its objectives. To overcome these challenges and strengthen the internal audit function in public sector governance, several key recommendations are proposed. Firstly, measures should be taken to bolster independence by establishing direct reporting lines to the highest governance level and protecting against undue influence. Adequate allocation of resources—budgetary, staffing, and technological—is imperative to enable comprehensive audits. Continuous professional development opportunities should be offered to internal auditors, focusing on emerging areas like technology, data analytics, and risk management. Additionally, staying updated on regulatory changes and fostering a culture of accountability, ethics, and transparency within the organization are crucial steps. Collaboration among stakeholders, education about the role of internal audit, embracing technology, and enhancing communication channels for effective reporting and value communication are further recommended. Lastly, mechanisms must be implemented to monitor and ensure the timely implementation of audit recommendations.

In essence, these recommendations aim to fortify the internal audit's efficacy by ensuring independence, resource sufficiency, skill development, regulatory awareness, ethical culture, collaboration, technological advancement, effective communication, and thorough implementation tracking of audit recommendations within the public sector governance framework.

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