

Auditors' and PAC Members' Views on Performance Auditing Practices in Malaysia: A Qualitative Approach

Zaidi Mat Daud^{1*} and Ian Fraser²

¹*Department of Accounting and Finance, Faculty of Economics and Management, Universiti Putra Malaysia, 43400 UPM Serdang, Selangor, Malaysia*

²*Accounting and Finance Division, School of Management, University of Stirling, U.K*

ABSTRACT

This study explored the views of both auditors in the National Audit Department (NAD), and Public Accounts Committee (PAC) members toward the current performance-audit practices in the Malaysian public sector by interviewing selected members of each group. Results revealed that the views of these two groups diverged on several issues concerning auditor roles and responsibilities, auditor competence and independence, as well as the format, content and usefulness of the audit reports. The most significant divergence was in the respective views on the auditors' responsibilities for fraud detection.

Keywords: Performance auditing, Auditor General, Public sector accounting, Malaysia

INTRODUCTION

Performance auditing has been recognised as an important management tool for monitoring the performance of government agencies (Driessen & Molenkamp, 1993; Rauum & Soniat, 1993; AGA, 2006). Generally, auditing is used to evaluate specific government programmes to determine their efficiency, effectiveness of

implementation and fiscal responsibility, as well as to decide on whether the programmes have achieved their goals.

The development of performance auditing in Malaysia can be traced back to 1978. The public (*via* Parliament) realised that audit reports based on financial information alone were not sufficient to hold government agencies accountable in carrying out their programmes and activities (Hazman, 1991). Consequently, the National Audit Department (NAD), as the institution responsible for auditing all government entities, was given the authority to amend the Audit Act of 1957.

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E-mail addresses:

mrzaidi@upm.edu.my (Zaidi Mat Daud),

i.a.fraser@stir.ac.uk (Ian Fraser)

* Corresponding author

Section 6(d) of the Act gave the Auditor General power to inquire whether the resources allocated by the parliament were being applied efficiently to selected governmental programmes and activities. Four years later, a second amendment was passed, expanding the audit scope to include performance auditing, giving the Auditor General the authority to question government agencies on the effectiveness of their programmes.

The major focus of this study was to investigate the current strengths and weaknesses of performance auditing and to determine the type of improvements to be done. Even though performance auditing has been in place in Malaysia for more than three decades, there is growing evidence that auditing recommendations are not consistently implemented (Daud, 2008), and there have been no studies on how the recipients actually use the audit reports. If performance auditing is to be a useful tool that can add value to the performance of government agencies, the audit reports must clearly understood and their recommendations implemented. There is, therefore, a clear need for a new research on users' perceptions toward, and expectations of, audit reports. There is no point in providing audit services if they do not result in efficiency and productivity improvements.

This study contributes to these efforts in two ways. First, it adds to the literature on performance auditing in developing countries. Secondly, the findings can help auditors in these countries become more effective. The success or failure

of performance auditing needs to be measured not only from the perspective of the auditors, but also from the perspective of the users of audit reports, in this case, Public Accounts Committee (PAC) members. The findings of this study can be useful to NAD in their policy formulation and in developing programmes to optimise the value of performance auditing so that it can adequately fulfil the information needs of Malaysian users.

The remainder of this paper is organised as follows. The next section provides background on performance auditing in Malaysia and its relationship with NAD, which includes a brief discussion of some previous studies. The report then outlines the research method used and discusses the findings. The final section presents the conclusions.

LITERATURE REVIEW

Performance Auditing and National Audit Department (NAD)

National Audit Department (NAD) is the national agency in Malaysia that has been given the mandate to conduct various types of audits of public agencies throughout the country. NAD was originally empowered by two laws: the Malaysian Constitution and the Audit Act of 1957. According to Article 105 of the Constitution, the Auditor General is the head of NAD who is appointed by the Yang DiPertuan Agong (YDPA) on the advice of the Prime Minister after consultation with the Conference of Rulers. NAD assists the Auditor General in implementing the audit mandate to provide

an independent review of the performance and financial management of public sector agencies and bodies (NAD, 2006). Under Sections 9 (1) and 6 of the Audit Act of 1957, NAD is entrusted with the task of ensuring accountability in the administration and management of public funds through the audit of accounts and activities of the Federal government, State governments, statutory bodies, local authorities, and the Islamic Religious Councils, and a few other publicly funded organisations.

Prior Studies

A review of the literature shows that most studies of performance auditing have been confined to developed countries mainly in the U.K., New Zealand and Australia. Furthermore, many of these studies concentrated mainly on concepts rather than on the practical side of performance auditing. To date, only Pendlebury and Shreim (1990; 1991), Chowdhury and Innes (1998) and Johnsen *et al.* (2005) have undertaken research to investigate the divergence of views between auditors and users toward performance auditing practices in the public sector. An earlier empirical study was conducted in the U.K. by Pendlebury and Shreim (1990) with the objective of examining the attitudes of external auditors on the implementation effectiveness of audits in the public sector. The external auditors in that study included those from the Audit Commission, some from the National Audit Office, and others from private accounting firms. The findings revealed that there was consensus among

auditors that auditing is primarily concerned with economy and efficiency rather than effectiveness; effectiveness auditors rely more on personal judgment than on objective evidence; and audit teams should consist of auditors from several different disciplines.

A year later, Pendlebury and Shreim (1991) extended their previous study by examining the attitudes of public-sector managers and financial officers of local authorities in England and Wales from two sectors of environmental health and finance. The results of the study were then compared with those from the Audit Commission group in the earlier study. This second study found that there were divergent opinions on the objectives of effectiveness auditing, composition of audit teams, and suitability of auditors to conduct effectiveness auditing.

Another related study was undertaken by Johnsen *et al.* (2001) in Finland and Norway. They explored the perceptions of the auditors and auditees on the usefulness of audit reports and the efficiency of performance auditing. The researchers discovered that both groups of auditees had little faith in performance audit reports. In Finland, auditees regarded the reports as not useful because they lacked valuable information and were too complicated to understand, while those in Norway regarded the auditors as incompetent and the reports were therefore not trustworthy.

The current study differs from the above-mentioned prior research by focusing specifically on the practices of performance auditing in Malaysia. It aims

to furnish evidence of the divergent views on performance audit practices in the Malaysian public sector by soliciting the perceptions of both auditors in the National Audit Department (NAD) and Public Accounts Committee (PAC) members.

RESEARCH METHOD

This study was aimed at exploring whether there is any divergence of views toward performance audit practices in the public sector, and if so, in which areas such divergence exists. Thus, a qualitative approach to data analysis was taken to be the most suitable and appropriate for achieving the research objectives. A semi-structured interview approach was used because it was judged to provide more in-depth insights into the views of the study participants.

The interviews were conducted with 12 auditors of NAD and eight PAC members, using an interview schedule based on a review of the literature. A list of the interviewees by occupation is provided in Table 1. The PAC members were chosen mainly because they were the direct or main users of the Auditor General's audit reports. Numerous measures were undertaken to minimise possible biases through preparation and careful design of the interview questions, and in the conduct of the interviews. The interview lasted from 45 minutes to one and half hours, and was undertaken at each interviewee's office or in another location determined by the interviewee. The interviews were tape-recorded and transcribed, and summaries of the transcripts were subsequently verified by the original interviewees.

TABLE 1
Interviewees and their occupations

| Participant | Position |
|-------------|---|
| Auditor 1 | State Audit Director |
| Auditor 2 | State Audit Director |
| Auditor 3 | Deputy Audit Director |
| Auditor 4 | Deputy Audit Director |
| Auditor 5 | Deputy Audit Director |
| Auditor 6 | Deputy Audit Director |
| Auditor 7 | Deputy Audit Director |
| Auditor 8 | Senior Auditor |
| Auditor 9 | Senior Auditor |
| Auditor 10 | Senior Auditor |
| Auditor 11 | Senior Auditor |
| Auditor 12 | Junior Auditor |
| PAC 1 | Member of Parliament – Opposition Party |
| PAC 2 | Member of Parliament – Opposition Party |
| PAC 3 | Member of Parliament – Government Party |
| PAC 4 | Member of Parliament – Government Party |
| PAC 5 | Member of Parliament – Government Party |
| PAC 6 | Member of Parliament – Opposition Party |
| PAC 7 | Member of Parliament – Government Party |
| PAC 8 | Member of Parliament – Government Party |

FINDINGS

The research findings of this study are presented and discussed according to specific themes such as auditor roles and responsibilities, auditor independence, auditor competence and audit reporting. They show some intriguing outcomes.

Auditor Roles and Responsibilities

All the auditors agreed that it was not their duty to detect fraud, arguing that it is rather the management's responsibility to detect fraud and suspicious activities.

"Not many people are clear as to our role and management's role relating to fraud. Many people believe that detecting fraud is the concern of auditors. This is incorrect. Our role is to evaluate the adequacy of the existing system of internal controls by analyzing and testing. In this case, if we suspect fraud, then we will report it. The management is responsible for detecting any suspected fraud." (Auditor 9)

Another auditor concurred that the public always misunderstands the responsibility of auditors with regard to this role, often expecting auditors to discover fraudulent activities in government agencies. Similarly, all the auditors agreed that it was not their responsibility to report fraudulent activities to the relevant authorities.

"We only bring matters to the attention of the relevant authority, normally the Anti-Corruption Agency (ACA) if the fraud is significant. Usually, we just inform the management if we come across any suspected fraud or irregularities." (Auditor 2)

PAC members, on the other hand, were clearly disappointed with the auditors' present efforts of detecting fraud. One PAC member reported that the lack of an audit mandate was the main reason auditors turned away from this particular role. Another PAC member felt that it was the absence of formal procedures for detecting fraud. She stated:

"At the moment, no. There are so many things that have to be done by the Auditor General. As far as I am concerned, they do not go for fraud. They only investigate when they discover or suspect something is wrong, or any misappropriation exists during the audit; thus, this one aspect needs to be improved. What happens if they do not discover it during the audit? The procedures should be there to be followed by the auditors." (PAC 6)

With regard to fraud reporting, all PAC members seemed to be pleased with the present practices of auditors. The auditors regularly inform them of any incidents referred to the respective authorities and adequately highlight these in the audit reports. The comment below summarises the PAC members' perspectives on this role:

"They did a good job in terms of reporting [fraud]. They highlighted in the report about their findings. Based on what they said [during a PAC meeting], sometimes, they also referred the case to the MACC [Malaysian Anti-Corruption Commission]." (PAC 6)

Auditor's Independence

A general trend in the perceptions of the auditors is that they are free from external influence because the decisions they make are based on available facts and evidence. Nevertheless, a few auditors claimed that there were occasions where they received warnings and memoranda from certain parties requesting auditors not to disclose certain information in the audit report.

"Usually, when it happens, they ask us not to disclose such information. It all depends on our top management. Usually we do not disclose reports like that to the public." (Auditor 7)

PAC members showed mixed reactions on this issue. All the PAC members from the government parties perceived that the auditors were free of influence from any party. However, two PAC members from the opposition parties claimed that influence from outside parties is possible despite the guarantee of independence of the Auditor General required under the constitution and the Audit Act 1957, as claimed by one PAC member:

"...the Auditor General is still under government control. If they are too aggressive, they might be subjected to actions by the Prime Minister. For example in the case of auditing the Finance Ministry, politicians would get involved. This is a sensitive issue." (PAC 1)

In addition, the interviewees were asked about the suitability of the NAD in providing professional management advisory services (MAS) to the auditees. As

expected, the auditors did not perceive that this role would impair their independence. They argued that decision still rest with the management and auditors are there only to advice the agencies.

"Let's say the auditee comes to us and asks for help in developing the rules or procedures for a project....we will help them but in the context of advising them only. We might say that this procedure is against the Treasury guidelines... or accounting principles or whatever and ask them to consider other options. In some cases, we might suggest a few options... but at the end it is up to the auditee to decide." (Auditor 2)

The PAC members generally agreed among themselves, however, that offering MAS to the auditees would indeed impair the auditors' independence because they might be auditing their own work and establishing a close relationship with the auditees. However, they were quick to add that this provision is not an issue in the public sector as long as the auditors only offer help and provide advice or suggestions.

Auditor Competence

Auditors expressed satisfaction with their own level of competence. They perceived that their current level of qualification, which requires a minimum degree in accounting, is adequate. They also believe that they have the necessary skills to carry out performance auditing. However, they also noted that obtaining a reasonable level

of experience in professional financial work is essential. All, except for one of the PAC members, thought that the auditors have adequate qualifications and skills, and that the procedure for the appointment of auditors is proper. Furthermore, they believe that auditors are subjected to continuous performance monitoring and provided with proper training. On the issue of hiring auditors from disciplines other than accounting, not all auditors shared the same views. Most of them supported the idea of employing new auditors from other disciplines, arguing that the knowledge and views of these new auditors would lead to better processes and outcomes. However, two auditors were against the idea of hiring auditors from other academic backgrounds, fearing that this practice would result in overstaffing in the long term, and that the present practice of seeking assistance from other government agencies is more practical. All the PAC members were in favour of NAD's employing people from different disciplines to conduct performance audits, averring that some projects would require individuals who are knowledgeable in fields other than accounting.

Audit Reporting

Most auditors held the view that the contents of audit reports are adequate and they are also confident that these contents meet the users' information requirements. They also believe that audit reports are useful to users. Most of them cited the use of the 'balanced reporting' approach—addressing not only the weaknesses or

the problems of a programme but also its successes and strengths—to support this view. Furthermore, the auditors explained that NAD regularly reviews the contents of report in terms of its structure, language and graphics so as to assist users in understanding the report. Unexpectedly, one senior auditor perceived that the audit report is not effective because of its outdated information, dissuading the users from implementing any recommendations. She remarked:

"I think the users do not use the information. Our audit report is not effective because the issues discussed are outdated." (Auditor 2)

Audit reports were also thought to be limited in usefulness as they only describe what the auditors did and make impractical recommendations. Two PAC members concurred in this view, claiming that the present audit reports lack useful information such as expenditures, resources used and the impacts of audited programmes on the auditees and the public. Regarding the types of information that need to be included in the reports, the PAC members stressed that critical analyses on the performance and progress of programmes, including financial information, precise audit opinions and disagreements among the auditees on particular issues, need to be emphasised. One of the PAC members also expressed the need to include comments or statements from experts who have been involved with the audit. These comments may indicate that the auditors are not adequately addressing the users' expectations in terms of programme performance.

In contrast to the opinions of the auditors, most PAC members expressed dissatisfaction with the information included in the reports. Three PAC members claimed that the issues in the reports were outdated and believed this to be the main reason the public is not interested to read them.

“One of the big problems is that by the time certain problems are identified and put in the audit report, it’s possibly one or two years late. For instance, this happened two years ago but the report was produced last year. By the time the Auditor General identified the problem, it was already two or three years late, and it was another one or two years by the time it was presented to the parliament. Do you think people out there would be interested in this issue... maybe they already know by the time the audit report is published.” (PAC 3)

Other PAC members mentioned that audit reports are descriptive in nature and fail to critically analyse multiple aspects of programmes.

“Actually, the auditors just record what the people did. They just list the problems, efficiencies, and delays..., such as why this money is not used and why so much money is used? ... they need to say what is the impact of the project.” (PAC 2)

As for the format of the audit report, the auditors indicated that the present format is adequate and very helpful to users reading the audit report. They also believe that no modification is required for the format. Although the auditors concurred that the

current audit reports are too voluminous for many users, they argued that this is unavoidable because of the nature of the audit, which involves non-financial information. Nonetheless, one auditor did not perceive the current format as the main factor in discouraging the public from reading the audit report.

“It is not because the audit report looks so thick that makes the public reluctant to read. It has something to do with the attitude of our people. They do not care about what happens around them.” (Auditor 7)

The PAC members, however, believe that the format of audit reports needs to be improved. The present format was deemed inappropriate because it is standardised for all reports. Alternatively, they prefer to have a format that is more flexible and can be customised to the specific needs of an audit. One suggestion by the PAC members is to have an executive summary:

“It would be helpful if the auditors can provide the executive summary in the front section of the audit report. It would be much easier for me as a PAC member to get straight to the problems. There are lots of reports that I need to look at.” (PAC 1)

Three PAC members considered the current format to be too long, believing that it would lead to important issues being overlooked in the audit opinion or that users might be discouraged from reading it. Nevertheless, many of them agreed that the current format provided some benefits in terms of outlining the methods employed and the objectives of the audits.

DISCUSSION AND CONCLUSIONS

The findings show that there is a significant divergence between auditors and PAC members about the duty of auditors to detect fraud. The present practice, certainly, is that the NAD auditors do not actively look for fraud and only report it if their suspicions are aroused during the course of the audit. The main reason for this approach is the absence of a specific mandate for fraud detection. PAC members, on the other hand, expect fraud detection to be a major reason for performing audits, while Chowdhury and Innes (1998) argued that fraud detection is an implied constitutional mandate. Clearly, the lack of a statutory requirement for fraud detection leads the auditors to believe that such detection is not a part of their duties, which contradicts with PAC members' expectations.

As for the issue of auditors' independence, most auditors claimed that they base their findings on the evidence, regardless of whether they have been subjected to any pressure from management or outside parties. Nevertheless, two auditors admitted that they were not allowed to include certain national-security-related or other controversial issues in their audit reports, and two out of eight PAC members believed that auditors could not always maintain their independence from external pressures, especially from politicians. They were convinced that the government administration still has at least a subtle indirect control over the NAD, primarily because the Auditor General is appointed on the recommendation of the Prime

Minister. The study found that some senior auditors did feel this influence, claiming that they are under pressure from their own managers and other governmental officers. This finding is in line with the work of McCrae and Vada (1997), which disclosed that the independence of the Auditor General is threatened by administrative forces who want to reduce audit operations and use their political leverage to influence audit results. This finding is also consistent with Chowdhury and Innes (1998), who found that, while auditors insisted that they are free from external influence, users perceived that the auditors are heavily influenced by their own management.

Another finding of this study is that, with the exception to two PAC members, auditors and PAC members agreed about the comprehensiveness of audit reports. Both groups considered the audit reports fair and balanced, incorporating sufficient information on the progress and impacts of the programmes audited. The reports include clear statements of the auditors' opinions on particular issues, delineate management responsibility regarding those issues, and critique both strengths and weaknesses of the programmes. This finding is inconsistent, though, with Johnsen *et al.* (2001) who found that audit reports were overloaded with detailed information not actually useful to auditee management.

There was also a significant difference in the opinions of auditors and PAC members about the adequacy of the audit report format to meet users' information requirements. All the auditors believe that

the present format and length of audit reports is appropriate because subjective matters and non-financial information require lengthy explanations. They also felt that the standardised format makes the report easy to comprehend as it includes sections on all the critical aspects of programmes: planning, implementation, and monitoring.

In conclusion, the findings of this study showed that auditors and PAC members held different views about auditors' independence, roles and responsibilities, as well as about the audit reports' timeliness, content and format. Furthermore, these differences were substantive, not mere misunderstandings or inconsistencies in methods or standards. The most critical disagreement was over auditors' role in detecting fraud, with PAC members believing such detection to be a major part of the job and auditors demurring that they had no specific mandate for such an approach.

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