

## **Chapter 5**

### **Discussion and Conclusion**

#### **5.0 Introduction**

This chapter discusses the results previously presented and analyzed in chapter 4. From the discussion that follows, a number of conclusions can be drawn together with some practical implications. This chapter provides conclusion of the study and suggests recommendations for future research. Some limitations of the study will also be highlighted.

#### **5.1 Recapitulation of the Study**

The recent conducted researches on internal auditing show distinct variations in internal audit practices (see Allegrini et al., 2006; Cooper et al., 2006; Gramling et al., 2004; Hass et al., 2006 for detailed literature reviews). The existing literature on internal auditing provides fragmented evidence and discussion on the reasons for these differences to exist. This research however, attempts to explore the company specific factors that motivate internal auditor's adoption of RBA approach in their auditing work, the very concept which drives the profession to focus warranted attention and resources in guiding and managing organizational risks.

#### **5.2 Implications of the Research Findings**

The findings do contribute to the existing knowledge amassed in this area of study, providing some valuable insights and understanding as to how company specific factors are associated with the adoption of RBA in practice in Malaysia. Most of the prior literature on

the related aspects of internal auditing of this study focused on empirical evidence from non-ASEAN settings (Goodwin-Stewart and Kent, (2006); McNamee and Selim (1998); Allegrini and D'Onza (2003); Castanheir, Rodrigues & Craig (2009)) where different risk culture and corporate governance practices and regulatory requirements impact the maturity of business risk management and internal auditing practices. Hence, differences in findings on the empirical studies in this regard are therefore reasonable.

However, the implications extended from the findings provide several invaluable insights to the adoption and practice of risk based internal auditing approach. Most of the organisations surveyed tend to practice a risk based or mixed approach in their annual audit planning (macro level) but are more of control based and less of risk based when performing individual audit engagement across all company specific factor groupings adopted in this study. Risk based approach is widely regarded as the best practice by the respondents as it allows prioritisation of resources whilst helping organisations to minimise business risks and achieve their goals. The wide acknowledgement of the advantages of RBA in aligning IA's assurance objective to organisational goals is prevalent amongst the organisations surveyed. Due to its overwhelming adoption at macro level, the study fails to find any distinct association between RBA with company specific factors. Regardless of the company specific characteristics (factors), it is viewed as a practical and effective approach to overcome the constraints in the deployment of internal auditing resources often faced by many organisations whilst providing an defensible audit plan that is prioritised towards ensuring effectiveness of operational and business activities. Practitioners can take heed of the superiority of this approach to justify IA resources allocation and budget demand whilst focusing on areas that are critical to the achievement of their organisational goals. RBA improves corporate governance practice as it seeks to balance the competing demands of the stakeholders when

meeting their organisation's goals and objectives. With the Malaysian companies are more inclined, as the study revealed, to adopt a more risk based approach to internal auditing at macro level, any impetus to promote greater RBA adoption should face with less resistance.

The RBA adoption however, does not cascaded down to micro level where less risk oriented and more control based focus is placed when conducting individual audit engagements as the study found. In many of the organisations surveyed, the effectiveness of internal control system is still a predominant consideration. Though there is a general trend based on the literature review that the focus of internal auditing has evolved from a system or control based approach to that of risk based, there is still a stronger tendency amongst the Malaysian companies to adopt a control based approach. The demand to ensure that the organisation's internal control system is working effectively, takes precedence over the management of risk at micro level with most organisations. Although the concept of risk is not a new phenomenon to internal audit profession, there is a strong inclination to adopt a system based approach. The control paradigm is still very much embedded in the IA work mindset when conducting their auditing engagements at micro level. This will also curtail internal auditing's contribution and responsiveness to risk management activities as the study found when examining IA's responsiveness to ERM at micro level. Based on the observation from the study, it appears that the application of risk based approach to internal auditing at micro level has not thoroughly appreciated and is lacking despite calls by Turnbull Report (1999) for the adoption of risk-based approaches to internal control and on the subsequent monitoring of their effectiveness (Fraser and Henry, 2007). The control paradigm and subsequent lacking of application of RBA approach could be caused by the general level of maturity of the risk management practices and the risk culture in Malaysia which influence the objectives of the audit engagements, the design of audit programmes to test activities and

the manner findings are reported to management . The general maturity level of corporate governance practice in Malaysia which play a notable role in conditioning the business environments and influence the demand of the management and internal auditing focus could well play its part in shaping the extent of RBA adoption. If this were the case, it is expected that as the corporate governance practice matures, the corporate risk culture and the adoption of risk based approach should increase.

The study also, found that RBA approach is being adopted selectively at micro level depending on the organisation's specific factors. Finance industry which is widely known to be in the forefront in risk management practices due to its highly structured business environment and the regulatory requirements the industry subject to, their focus on auditing engagement is aligned to risk based complementing to the organisation's risk management initiatives. This assertion is supported statistically in this study as well as consistent with the study done by Shiu & Yeh (2008) on Taiwanese banking industry where more than half of the banks reported over 60% of their internal audit activities are risk oriented. The pressure to be competitive and profitable remain the prime goals of companies in the private sector with their management's compensation and job quite often tied to the company performance. Risk based approach would complement the private companies and the management's endeavors to achieving their objectives and remain profitable. Hence, IA in private companies have higher tendency to adopt RBA as compare to organisations in the public sector which may not subject to the same intensity for performance. This implies that RBA adoption at micro level is influenced by regulatory requirements and business considerations at least amongst the Malaysian companies. It also implies that RBA adoption at micro level can be influenced by imposition of regulatory requirements and standards.

In meeting the stakeholders' expectations which often are translated into the company's objectives, there are strong grounds for internal auditing to adopt a RBA approach wholesale and for the organization to embrace the ERM concept in management the business risks. The responsiveness and extent of internal auditor's involvement in enterprise risk management activities would be conditioned by business, regulatory and environmental demands. In line with the extensive adoption of RBA at macro level, it is found statistically significant that the responsiveness of internal auditors to ERM activities increase with RBA adoption. It is expected that by adopting RBA approach for enterprise wide audit planning, internal auditors would lend themselves to greater receptiveness to involvement in enterprise wide risk management activities. When planning for annual audit schedule at macro level using the RBA approach, internal auditors would establish the risk profile of auditable units and prioritise them accordingly. This would allow internal auditors not only to focus their resources in high risk areas but to clearly understand their organisation's risk profiles and gaps and how these gaps could affect the overall achievement of the organisation's goals. This could lead them to be more responsive to involvement in ERM activities particularly those legitimate and inappropriate activities. Any efforts or factors that promote the adoption of RBA at macro level would increase IA's responsiveness to ERM activities. Similarly, the knowledge on the factors that motivate IA's responsiveness as well as the possible obstacles that would deter IA from being actually involved in ERM activities eg. lack of required expertise, outsourced of IA function, existence of risk management department etc, could further assist in the understanding of their responsiveness to ERM activities.

An interesting and significant contribution of the study came from the examination of the influence of company specific factors on IA's responsiveness to ERM activities. Statistically significant association is found between non finance companies and IA's

responsiveness to ERM activities. The results is consistent with a previous related study carried out in Malaysia where it was noted that the internal auditors in the banking industry were found to perform more of their ERM assurance roles while the internal auditors in the non-banking industry were reported to perform almost equal proportion of their ERM assurance and consulting roles (Kasim, 2011). Consistent with survey, most finance companies have already had in place, a robust risk management structure often spearheaded by a non IA department or personnel and coupled with the highly regulated finance industry, internal auditors in this industry likely to confine themselves to assurance roles on ERM activities (Kasim, 2011). Similar statistically significant associations also found between both 'non-Internationalised' and 'non listed' companies with IA's responsiveness to ERM activities. In the more established organisations in terms of ownerships (Listed) or operations (Internationalisation), a formal ERM process is usually found and this process is often overseen by a separate risk management department and led by a designated person other than internal auditors. It can be argued that the initiatives and responsiveness of internal auditors in leading the ERM initiatives would somewhat be curtailed under these circumstances. Though the results of this study support these assertions (associations) statistically, further research on this respect would be warranted. On a separate but related note, the proposed negative association between organisation size and the responsiveness of IA to ERM activities garners some weak but insignificant statistical support. This is consistent with the findings in previous studies conducted by Castanheir, Rodrigues & Craig (2009) and Jackson (2005). IA often find themselves responding to ERM demands in the absence of a designated department or personnel to driving these initiatives particularly when resources are lacking especially in the case of small organisations where IA would most likely be called upon to involve in many risk related initiatives and consulting activities by management. Similar to the findings on RBA adoption, the responsiveness of IA to ERM activities is also conditioned by regulatory

requirements and business considerations of the relevant company specific factors. The finding provides insights as to the considerations which motivate IA's responsiveness and this knowledge should equip the profession in setting guidelines and standards on IA's involvement in ERM that impact organisations of different industries, sectors, sizes etc.

### **5.3 Limitations of the Study**

The results of this research study should be considered in the light of the limitations highlighted in this section. One weakness is that the survey also covered those IA practitioners who are 'too junior' and might not have sufficient knowledge and good appreciation on the concept of risk based auditing at this juncture to provide a balanced opinion. The lack of understanding and subjective judgments amongst respondents in what risk based auditing concept and approach entailed present a limitation to this study.

This survey adopted a non probability sampling design ie convenience sampling. Though the sampling methods employed may be a practical, quick and cost efficient way to obtain research data, the findings from these modes of sampling may not be confidently generalised to the population ie. cannot be viewed to be an actual representation of the population. Moreover, in the case of data collected from IIA workshop, there was always the possibility of more than one respondents from same organisation providing their input to the survey.

This approach pre-cludes a better and more indepth understanding of the manner internal auditors of various establishments adopt RBA and reasons for the extent of

involvement in risk management activities. For a more comprehensive and informative study, face to face interviews of respondents should be adopted to complement the survey findings. Also, a bigger and more diverse sample may yield more reflective and generalisable results.

Being cross sectional but time specific oriented, this study is faced with limitations associated to this nature. The responsiveness and involvement of internal auditors in risk management would be influenced by a constantly evolution of the Malaysia's business and regulatory environment especially as the Malaysia corporate governance landscape gradually matures.

#### **5.4 Suggestions for Future Research**

The factors examined in this study were internal ie. company specific. The external factors that would influence the adoption of risk based auditing approach have not been considered. The impact of external conditions would be crucial to the overall development in this respect particularly in this globalised world. There are existing literatures that explored company specific determinants in the adoption of RBA approach by internal auditors. However, there is an apparent lacking of studies (none per researcher's literature review) exploring external conditions or factors to the same effect. Nevertheless, extensive studies have been carried out to establish the drivers or factors that influence the adoption of ERM by organizations, some of which are found to have influenced the adoption of risk based auditing by internal auditor as well e.g. size and industry (Za'rate, 2001; Goodwin-Stewart and Kent, 2006; McNamee and Selim, 1998; Castanheir, Rodrigues & Craig 2009). It is therefore proposed that other factors, both external and internal particularly those which influence the adoption of ERM would also similarly influence the adoption of RBA by IA. Internal factors



such as existence of risk management committee, board size, internal auditor's technical competency and institutional shareholdings are found to influence the degree of adoption of risk based auditing approach in a study conducted (Shiu and Yeh, 2008). Future research in this aspect would be beneficial.

The evolving business and regulatory environment provides the opportunities to conduct a longitudinal research with the same focus be conducted to establish how internal auditing responsiveness to risk management would change over time particularly in context of macro changes in Malaysia eg. changes in the corporate governance landscape. This research also can provide a platform to expand the current knowledge already amassed in this area of study. Based on the existing studies, differences in culture (Sarens and Abdolmohammadi, 2010a), degree of economic development (Abdolmohammadi and Tucker, 2002), corporate governance requirements and maturity (Cenker and Nagy, 2004; Page and Spira, 2004), also found to have contributed to the variability in internal auditing practice amongst countries worldwide. It is therefore proposed that studies be conducted to examine how differing culture, levels of economic development, maturity in corporate governance practice etc. could influence the profession's responsiveness to risk management activities in various countries particularly in SEA region. On a similar note, explorations of RBA in other national settings with differing regulatory framework and culture would provide a better understanding of the factors that influence of the adoption of RBA and patterns of professional internal auditing practice especially in risk management activities.

Another area worth exploring would be to investigate to examine how might internal auditor's responsiveness to risk management activities be affected if the IA's function is

outsourced or with the existence of risk management department or CRO in the organisation to lead the risk management initiatives.

Last but not least, another interesting proposition would be to extend the study to examine the moderating effect of the responsiveness of IA to ERM activities with the actual involvement of IA in ERM work. The findings in this study should be able to clarify further the drivers that influence IA's responsiveness as opposed to their actual involvement in ERM activities.

## **5.5 Conclusion**

This study provides a good insight on the determinants and reasons for the adoption of risk based auditing in practice and how it impacts the responsiveness of internal auditors to risk management activities. The findings highlight the inclination to the adoption of risk based and control based approaches at macro and micro levels respectively as well as the importance of the regulatory requirements and business considerations in influencing both the RBA adoption by Malaysian companies as well as the responsiveness of IA in ERM activities. The prevalence of control paradigm amongst the organisations in Malaysia as noted in this study, would reduce internal auditing's contribution and involvement in ERM initiatives of their respective organisations. On the other hand, company specific factors, 'non finance', 'non-Internationalised' and 'non listed' companies are found to have direct impact on IA's responsiveness to ERM activities. Internal auditors in these companies which often subject to resource constraints that include not having a separate department and personnel to lead ERM activities, are most likely be called upon to involve in many risk related initiatives and consulting activities by management.

As the Malaysian economy progresses to the developed nation status and its corporate governance practice matures, the paradigm of business risks of the corporate should also evolves in tandem with the business demands. The findings should add value to the knowledge which the existing literatures in the area have amassed, the understanding which the profession and regulators could take stock of when setting guidelines and standards in this respect. There is no doubt that risk based internal auditing approach can assist organisations to proactively manage their strategic and operational risks effectively as it incorporates principles of risk management throughout the entire audit process both at the annual audit planning stage as well as during the planning, execution and reporting of individual audit engagements. Its adoption should complement the ERM practice by creating a positive risk culture and improves the risk mitigation process as well as to an extent, reduces its reaction time to risk issues. Those stakeholders who are equipped with the knowledge gained from this study, should be more receptive when dealing with companies that have greater tendency to RBA and ERM practices. It is expected that growing pressure from the stakeholders in ensuring the organisational goals are achieved, should serve as a strong basis for RBA and ERM practices to be extensively adopted. The knowledge and insights gained from this study should positively contribute to the understanding of the current internal auditing practices in Malaysia in this respect which the likes of IIA should bear in mind when setting standards or providing effective guidance to IA practitioners when involving in ERM.