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Thomas Schillemans, Mark van Twist, Martijn van der Steen & Ilsa de Jong

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New development: Breaking out or hanging on? Internal audit in government

Thomas Schillemans, Mark van Twist, Martijn van der Steen and Ilsa de Jong

Public audit is in transition. On the one hand, professional organizations claim it is time ‘to break out’ and develop new roles for auditors that ‘add more value’. On the other hand, critics are concerned about public sector accountability deficits necessitating more control and urging auditors to hold on to their traditional role. This article discusses tensions and relevance between these positions and their implications for auditing in government. The article will help policy-makers in their strategic decision-making on the role and focus of internal audit in government.

Keywords: Accountability deficits; accountability overload; control; internal audit; performance management.

A recent paper on the development of the internal audit profession worldwide (ACCA, 2014) argued that significant changes in and around the public sector mean that internal audit must move forward—just checking the books is no longer enough. Major financial crises have shown that auditing should not only be about accuracy and legitimacy of financial data, but should also be about the effectiveness and efficiency of the ‘machinery of government’ and its capability to deal with change and improvement. The boundaries of public audit need to widen to a profession that proactively contributes to the improvement of government.

The discipline of auditing is rooted in the ‘classic agency problem’ (Hayne and Salterio, 2014, p. 422). The need for internal control in complex organizations is generally driven by two key factors: information asymmetries and goal conflict among participants (Hayne and Salterio, 2014). The internal audit function is directly linked to both factors. Internal auditors serve as indirect monitoring instruments with which executives gather information about processes and activities within their organization which alleviates their informational disadvantages. Dampening information asymmetry is only necessary when agents with partially diverging interests are expected to stray away from stipulated paths. Internal auditing, then, is historically rooted in the struggle against misconduct and misappropriations within organizations. As Power (1997, p. 24) put it:

The aim is to look for irregularities, or ‘red flags’ that put the auditor on alert to possibilities of fraud.

Auditors are in a sense a ‘tool of management’, responsible for providing accurate information about the state of affairs of the organization. Power (1997, p. 83) speaks of auditing as a form of indirect self-observation. This makes auditors important ‘fact-checkers’ or ‘guardians’ of the norms in organizations (Van Twist et al., 2013).

However, the discipline has embarked upon a multi-directional journey away from its classical areas of application. Auditing has widened its scope from financial auditing to newer areas of expertise, such as risk management (Spira and Page, 2003) and operational performance (Gendron et al., 2007). Auditing has also become more ambitious in its purposes, from providing ‘comfort’ and ‘assurance’ to ‘added value’ (Humphrey et al., 2007, p. 4), ‘more diversified products’ (Bou-Raad, 2000, p. 183) and ‘the translation of…scrutiny into lasting change and improvement’ (ACCA, 2014, p. 3).

In the academic debate about the evolution of audit and accountability in the public sector, two diametrically-opposing frames have developed, pointing in opposite directions in terms of the development of the profession.
We refer to these here (based on their theoretical grounding/origin) as the ‘deficit’ school and the ‘excess’ school (Bovens et al., 2008).

**Audit deficits versus excess**

The first school of thought worries about audit deficits. The exponents of this school go through the public sector with a fine tooth-comb, finding ‘holes, ‘gaps’ and ‘deficiencies’ in public accountability in all kinds of areas. For example, they consider that public–private organizations, public interest entities, municipalities, the EU, other international bodies and policy networks more generally, are insufficiently accountable for the performance of their duties. A commonly-heard mantra in this school is ‘Where were the auditors?’ after crises and scandals (Clarke et al., 2014). A good example is Enron in 2001—in the debate that followed Enron’s collapse it was claimed that the auditors had lost their objectivity and independence as a result of their consulting activities (Wallace, 2003). Also, they had lost sight of their moral compass (Everett and Tremblay, 2014). The growing organizational complexity, our network society and hybridization of organizations leads to gaps in accountability, according to some (Fisher, 2004). The deficit school usually seeks to remedy this by means of further rules and regulations and intensifying regulatory regimes. Numerous audit and accountability gaps have been highlighted in recent years, many of which have been repaired through additional rules, higher standards and stricter audits (Behn, 2001; Bovens et al., 2008).

The opposing school of thought worries about audit and accountability overloads or even excesses. The exponents (Power, 1997; Hunt, 2003) of this school point to the increase in auditors, accountability bodies and administrative burdens in the public sector and argue that the accumulation of accountability arrangements resulted in an ‘accountability regime’ that completely defeats its purpose (Brennan, 1999). They criticise the expansion of courts of audits that have evolved from traditional accountants to ‘evaluators’ in a much broader context (Pollitt et al., 1999), and fear that many public bodies, public professionals and the government will be unable to shoulder the collective weight of the administrative processes required to meet the accountability obligations. According to the exponents of this school, we are living in an audit society and an accountability state, which feeds into unrealistic expectations and drives ineffective investments in supervision, audit and accountability arrangements (including internal audit). Their approach is one of ‘less is more’ or ‘lean and mean’. They often refer to the vital importance of trust, which can be damaged by excessive audits and controls. Bovens et al. (2008) claim that this school of thought includes public administrators as well as scholars who point to a growing ‘accountability dilemma’ (Behn, 2001), or argue that more accountability does not always mean better government (Koppell, 2005; Leeuw, 2011). See table 1 for a summary of the two schools of thought.

In this debate, ACCA has taken the more modern position (aligned with the ‘overload’ or ‘excess’ school), that auditors attach too much value to certainties, structures and clarity, and therefore calls for the formulation of new perspectives on the nature of audit work in the modern era, which should include daring to assess the performance of the policy-makers and leadership and to challenge their potentially outdated opinions and ideas. In contrast, the more traditional position (fed into by the ‘deficit’ school) asserts that auditors are not trained for such a role, nor will the policy-makers and leadership leave enough room for this.

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**Table 1. Deficits versus overloads.**

<table>
<thead>
<tr>
<th>Concerns</th>
<th>The ‘deficit’ school</th>
<th>The ‘overload’ school</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observations</td>
<td>Wrongdoings, abuses, scandals, out-of-control organizations.</td>
<td>Administrative burden, red-tape, beleaguered professionals, suffocating bureaucracy.</td>
</tr>
<tr>
<td>Explanations</td>
<td>Increasing complexity and fragmentation of decision-making, standards, management, supervision and implementation in the ‘age of governance’.</td>
<td>Increasing size of the ‘audit pillar’ and its increasing impact in terms of time, choices and resources in the age of the ‘audit explosion’.</td>
</tr>
<tr>
<td>Considerations</td>
<td>The purpose of auditing is to limit undesirable behaviour by ‘delegated policy implementers’.</td>
<td>The purpose of auditing is to encourage learning and effective behaviour by ‘professional policy implementers’.</td>
</tr>
</tbody>
</table>
Therefore, the sensible approach is for internal auditors to hold on to the core of their own professionalism.

The breaking out strategy of professional development is intuitively appealing. However, there are also many good arguments for the opposing strategy. Not adjusting but, instead, ‘holding on’ to the current professional basis, and being aware of the necessity of a certain level of institutionalized distrust, so that an understanding of complexity and dynamics cannot cross over into showing understanding for things that are illegitimate. This is the holding on strategy for the professional development of internal audit. This strategy focuses on retaining the classical principles of the profession, so as to very carefully look for ways to integrate innovations. Not adjusting to a complex and dynamic context outside of the internal audit profession, but holding on to the foundations, even if there are frictions between the professional standards and the expectations and ambitions existing in the contemporary professional practice. It comes from the conviction that the profession’s basis is that the auditor sticks to the standards, maintains a distance, does not adjust to the developments in the outside world, and does not show understanding for the dynamics and complexities that characterize the practice of public administration. Not because auditors do not comprehend what is happening, but because it is just as important to have professionals in the public sector who don’t show understanding but draw lines and make judgements on the basis of predetermined standards and don’t accept any margins in their measurements.

The strategy of holding on leaves some room for adjusting to a complex and dynamic ‘external’ context, but it is based on retaining and safeguarding the essence of the profession. The risk of this strategy is that the opportunity to link up to the expectations and ambitions outside of the profession is lost. The ‘breaking out’ strategy looks for a new essence of the internal audit profession that better suits the complexity and dynamics of the contemporary public sector. The obvious risk is that the profession will actually lose the characteristics that set it apart from related professions, such as controllers and other professions in the second line of defence.

The existence of these two opposing schools of thought is potentially difficult for internal auditors in doing their daily jobs. Internal auditors are ‘surrounded in the social web by a range of more or less contradictory discourses’ (Gendron and Spira, 2010, p. 278). Qualitative research on auditors underscores this point: the ‘social and normative environment’ of organizations is not an external reality but is treated by auditors as hard and important facts they have to work with (Radcliffe, 1999, p. 357). The evolution of internal audit comes with a multiplicity of roles which has been captured in various qualitative studies of (internal) auditing (Morin, 2003). Roussy (2013) identifies two key roles of the internal auditor. On the one hand, there is a protector role, subdivided into two dimensions: a protective shield and keeper of secrets. And, on the other hand, the internal auditor also has a role as a helper, supporting organizational performance and guidance. The traditional focus on audit as searching for red flags is slowly being replaced by a focus on audit as helpful mechanism in stimulating improvement. Auditors therefore need to find ways to both signal issues and risks as well as to provide guidance on quite divergent sets of governmental tasks (Roussy, 2013). Research suggests that internal auditors in government generally eschew the hard choice between opposing frames and use various coping strategies in order to serve different purposes (Schillemans and Van Twist, 2016). They try to break out while holding on, or vice versa.

**Looking for effective coping strategies**

All this puts the debate about breaking out or holding on into a different perspective: the critical question is not one of classic versus modern or conservative versus progressive but, rather, it is about where we can find room in the debate to ensure that the profession retains its basis while also being able to meet today’s challenges. The mission for the profession is to properly weigh up the interests involved in light of this. We would suggest that this is not necessarily a matter of choosing one of the two camps (and the associated contradictory expectations and ambitions) but, rather, of looking for coping strategies and accompanying practices through which the complex and also changing requirements can be made manageable. This is highly relevant for research on and the practice of management and control in government and sets an agenda exploring the realities, opportunities and limits of audit overloads and deficits, exploring how to break out while holding on to the traditional core of the profession.
IMPACT

This article addresses tensions in the professional practice of internal audit in government, which are often framed as dichotomous choices between modernization and tradition. This authors clarify these tensions between audit overloads and audit deficit, and between holding onto the core or breaking out to new practices, and suggest the perspective of coping as a way of reconciling various valid expectations.

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