

Limitations of Thai Local Government Internal Auditing in Detecting Risks

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Abstract

The primary objective of this study is to probe why internal auditing mechanisms fail to detect and deter common risks especially fraud and corruption risks in Northern Thai local governments and then to ascertain what are the crucial limitations that lead to ineffectiveness and/or weakness of the internal control and auditing systems. This study used a questionnaire and semi-structured interviews. Statistical techniques were used for analysing the questionnaires while content analysis with a phenomenological research approach based on Bandura's theory of moral disengagement was used for analysing the interview transcripts. This study found that a diversity of factors contribute to the ineffectiveness and/or weakness of Northern Thai local government internal auditing mechanisms in detecting and deterring common risks. The factors are the lack of independence of internal auditing systems and teams so that to achieving the internal auditing goals is difficult; a lack of cooperation and interest from officials for internal control systems and internal auditing teams while a lack of support from administrators for internal auditors' professional prospects. At the same time, the lack of internal auditing teams' competency for dealing effectively with administrators also contributes. The ineffectiveness is impacted by the ineffectiveness of Thai federal authorities to enforce their laws and regulations relating to common risks especially fraud and corruption risks. This situation must be addressed before local government internal auditing mechanisms can work efficiently and effectively.

Key words: Internal auditing; Common risks; Local government; North of Thailand

JEL Classification: C 19, G13, G 14

1. Introduction

Internal control and auditing systems are mechanisms to generate good governance in organisations (Gramling, O'Donnell & Vendervelde, 2010). These mechanisms are generally accepted as the means to prevent, detect and deter common risks (Ernst & Young, 2012; COSO, 2011). Among these risks, fraud and corruption risks are a problem particularly in developing countries (Stapenhurst, Johnston & Pellizo, 2006; Quah, 2003). Fraud and corruption is difficult to avoid when it occurs in organisations (Rahahleh, 2011; OECD, 2007; Quah, 2007;) especially those in the public sector (NESAC, 2004; Chatterjee, 2003). Within the public sector, corruption is generally defined simply as “the abuse or misuse of positions or resources of public officials for private gains” (Sandholtz & Koetzle, 2000, p.31). Such misuse is possible because of poor governance. Internal auditing systems have an important role in evaluating and improving the effectiveness of risk management, control, and governance processes and so creating confidence in this mechanism (Ricard, 2009; Chabrak & Daidj, 2007; Srichunpech, 2005).

Whether internal auditing mechanisms have been effective in detecting and deterring corruption in a particular developing country, Thailand (Haque, 2007; Kaufmann, 2005; Senior, 2004) is the focus of this paper. Thai local government is used to investigate the obstacles that have contributed to the failure of internal auditing mechanisms in preventing, detecting and deterring common risks including fraud and corruption. Annually, billions of baht from the local government budget are lost through wrongdoings of political administrators and local government officials despite Thailand having five independent organisations to fight corruption (OCSC-NIDA, 2010). As a result of corruption, Thailand was ranked 102 out of 177 countries in 2013 by an index issued by Transparency International (TIGCAC, 2013). This independent index covers issues such as bribery of public officials, kickbacks in public procurement, and the enforcement of anti-corruption laws. Unfortunately, these issues were discovered by the Office of The National Anti-Corruption (ONACC) (2011) to be present in Thailand. While previous studies found that the internal auditing systems in Thai local governments were ineffective in detecting and deterring corruption (Krueathep, 2009; Puang-Ngam, 2008; Phongpaichit, 2007; Seree-Rungsonke, 2006), this paper explores the primary factors that impact the effectiveness of those internal auditing mechanisms in preventing, detecting and deterring risks by examining the attitudes of Northern Thai local government internal auditors.

2. Literature Review

Fraud and corruption refers to the unethical behaviour of individuals and groups for private and factional gains (Rahahleh, 2011; Moore, 2008; OECD, 2007). Morally disengaged

individuals are generally able to engage in unethical conduct without apparent distress so that the corrupt behaviour becomes embedded within their normative behaviours (Moore, 2008). Moral disengagement refers to the process whereby an individual's behaviour changes from being ethical to unethical (Bandura, 2002; Bandura et al., 2001). Moral disengagement may explain why internal auditors and other officers are failing in their duty to prevent, detect and deter common risks within Thai local government especially fraud and corruption (OAG, 2010; OAG, 2008). A basic definition of corruption is "the abuse or misuse of positions or resources of public officials for private gains" (Sandholtz and Koetzle 2000, p.31) so that bribery, conflicts of interest, illegal gratuities as well as negotiation, gift-giving, predatory authority, and solidarity networks are corrupt behaviours which are commonly employed to conduct their wrongdoings in organisations such as Thai local governments (Rajivan et al., 2009; Lee & Kenny Oh, 2007; Albrecht, Albrecht & Albrecht, 2006).

Moral disengagement leads to questions about the motivation that can lead to involvement in corrupt behaviours. Organisational and cultural behaviours have been found to influence and overwhelm the behaviour of organisational members (Stewart, Sprinthall & Shafer, 2001) so that public officers might absorb both ethical and unethical behaviours (Sims & Keon, 1999). Cressey (2011) and Albrecht, Albrecht & Albrecht (2006) suggest that the psychological incentive for fraud and other unethical behaviour contains three elements: perceived incentives and pressures; perceived knowledge and opportunity; and perceived attitudes and rationalization. The first element, perceived incentives pressures, generally arises from the financial needs of individuals and their groups (Buosonte, 2003). These pressures can generate greed, living beyond one's means, high personal debt, poor credit, personal financial losses and unexpected financial needs as well as gambling habits, drug and alcohol habits, and expensive extramarital relationships (Albrecht, Albrecht & Albrecht, 2006). Work-related pressure and the system of fairness, equality and ethics within an enterprise can lead to corrupt behaviour of employees and officers if they feel they have been treated unfairly when compared with their fellow workers (Bartlett, Tonkin & Williams, 2004; Buosonte, 2003; Duffield & Grabosky, 2001). In relation to knowledge and opportunity, Cressey (2011) and Albrecht, et al. (2006) identify the means to avoid control systems; a lack of understanding of fraud techniques by those in authority; a failure to punish fraud perpetrators; and poor internal control and auditing systems, the focus of this study.

As Pickett (2004, p.3) stated, "Internal auditing is an independent, objective assurance and consulting activity designed to improve an organization's operations by bringing a systematic,

disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes". Despite Thai internal control and auditing systems following *The Framework of Committee of Sponsoring Organizations of the Treadway Commission (COSO)*, these systems are ignored or poorly implemented by public officers so that internal control and auditing guidelines are ineffective in improving risk management, control and governance processes so that fraud and corruption occurs (OAG, 2010; OAG, 2008). Khoury (2011) found that a lack of competence of the internal auditing team (Ho & Hutchinson, 2010) and/or support from administrators, independence of the internal auditing team, clarity of the objectives and scope of internal auditing and failure of internal control systems (Unegbu & Kida, 2011; Schelker & Eichenberger, 2010; Jensen, 1993) also contributed to the ineffectiveness. Similarly, Khoury (2011) found that ineffective public internal auditing came from internal auditors lacking motivation and growth prospects (Unegbu and Kida, 2011), accompanied by weak ethical practices especially in detecting corruption (Tackett, Wolf & Claypool, 2004). Attitudinal factors contribute to persons acting unethically; they are officials' lack of cooperation with internal auditors (Simmons, 2010), and a lack of understanding of corruption methods by internal auditors (Cressey, 2011; Rajivan et al., 2009).

The attitudes of Northern Thai local government internal auditors are investigated to ascertain whether those attitudes reflect moral disengagement which can lead to ineffectiveness of Thai local government internal auditing mechanisms.

3. Methodology

There were two stages to the research. Firstly, a survey was sent to 120 local government internal auditors in Northern Thailand. That survey focused on the systemic aspects as to why Thai local government internal auditing was ineffective. Ninety eight responses were returned. Recipients of the questionnaire were asked to volunteer for a semi-structured interview with one of the researchers. The interviews were the second stage of the research. The purpose was to examine attitudinal aspects, specifically how promotion prospects, motivation, ethical practices, understanding of internal auditing objectives, understanding of the methods of corruption and administrators' cooperation with internal auditors (Khoury, 2011) influenced attitudes. Six respondents volunteered and were independently interviewed.

The survey instrument was created and checked for reliability and validity before being sent. Data collected by the questionnaire was coded and checked for accuracy by an independent researcher and then analysed using SPSS. The interview data was analysed using NVIVO. Transcripts were thematically analysed through content analysis and further expounded using a

phenomenological research approach. The phenomenological research explains a situation as perceived by the individuals in that situation (Lin, Tan & Chang, 2008; Berg, 2007; Patton, 1990; Durfee, 1976). This approach abstracts out the themes and key issues. Commonly, two types of themes are found: those that occur across the group of participants and individual themes that are unique to a few individual participants.

4. Results and Discussion

The result of this study will be expounded into two parts: the survey findings and the interview findings.

4.1 The survey findings

The questionnaires were returned by 98 respondents (81.67%) and analysed using Pearson Chi Square and Pearson Correlation at the significance level 0.001. The results showed that Northern Thai local government internal auditors in small local governments (Municipalities and Sub-District Administrations) were not supported (95.10%) by their administrators for training in risk assessment processes due to training budgets that did not allow such training. The results also showed that local government officers (93.10%) and administrators (89.40%) have poor auditing knowledge. These factors would have contributed to the ineffectiveness of internal control and auditing systems for those administrative bodies. Surprisingly, Thai local government internal auditors have insufficient experience with internal audit workings although the majority (95%) of the respondents graduated with a Bachelor degree that included auditing subjects. Their lack of knowledge and experience relating to internal control and auditing (90.60%) would impact the effectiveness of internal auditors' audit planning. Adding to the problem is the insufficient numbers of internal auditors based in each administrative body. These problems can lead to ineffective Thai local government internal control and auditing mechanisms.

The attitudinal mean values must be interpreted through a measurable benchmark of attitudinal scales due to each factor having more than one question and each question having an equal value so that all questions for each factor were combined to calculate attitudinal mean values as "mid-range of five levels between strongly disagree (1) and strongly agree (5) indicating the strength of respondents' agreements and attitudes" (Likert, 1932). There are two parts: the factors, competency of the internal auditing team, officials' cooperation and promotion prospects, can explain the weakness of internal control and auditing systems in Northern Thai local governments. Other factors also attributed to the ineffectiveness of internal auditing in Northern Thai local governments. The findings (see Table 1) suggest that the competency of Northern Thai local government internal auditing teams is insufficient for preventing, detecting and deterring common risks including fraud and corruption risks. The poor competency is

compounded by the lack of cooperation from officials so that administrators in North Thai local governments have not supported and promoted the workings of their internal auditing teams. Thai local government internal auditors have a heavy workload because of their insufficient numbers. This issue has impacted the efficient and effective quality of internal auditors' workings. Similarly, their growth prospects, working motivation, salaries, promotions and special remunerations are miserly managed by Northern Thai local government administrators (Mihaela & Lulian, 2012; Vandervelde et al., 2012; Jensen, 1993). This situation has resulted in the weakness of internal control and auditing systems in Northern Thai local governments.

Table 1: Factors Reflecting to Limitation of Internal Auditing in Northern Thai Local Government

Factors Studied	Mean	Standard Deviation	Eigenvalue	% of Variance	Comparison with Measurable Benchmark Of Attitudinal Scale
Efficiency of Internal Auditing Processes	3.7015	0.6081	4.6610	11.369%	Agree
Independence of Internal Auditing Team	2.0211	0.2078	3.7150	9.062%	Disagree
Support from Administrators	2.1066	0.3023	3.7120	9.054%	Disagree
Audited Departments' Cooperation with Internal Auditing Team	2.4583	0.6661	3.4970	8.528%	Disagree
Competency of the Internal Auditing Team	3.6193	0.5974	3.4520	8.421%	Agree
Officials' Cooperation	4.6627	0.6245	3.0320	7.396%	Strongly Agree
Independence in Detecting Risk	1.5229	0.4931	2.9280	7.142%	Strongly Disagree
Interest of Officials	1.1928	0.4425	2.4450	5.962%	Strongly Disagree
Independence of Internal Auditing Department	1.4329	0.5558	2.3160	5.649%	Strongly Disagree
Promotion Prospects	4.8060	0.3890	1.7200	4.194%	Strongly Agree
Personal Independence	1.2663	0.4540	1.5740	3.840%	Strongly Disagree

Responses to the questionnaire (see Table 1) also indicate that the internal auditing teams lack independence, both departmental and personal, especially when attempting to detect risk. The lack of support for internal auditing from Northern Thai local government administrators suggests that these administrators do not accept the internal auditing mechanisms although these are part of the internal control systems. Despite this, the respondents indicated that they inform administrators about the auditing plans. However, when they seek evidence to support auditing outcomes, internal auditing teams' requests are often refused. The effect of these refusals leads to a lack of cooperation from officials in Thai local governments, a crucial obstacle hampering the achievement of the determined objectives and plans of internal auditing. These problems contribute to the ineffectiveness of internal control and auditing systems in Northern Thai local governments.

Factor analysis of the questionnaire responses indicates that the effectiveness of North Thai local government internal control and auditing systems can be predicted through 11 factors: efficiency of internal auditing processes, independence of the internal auditing team, support from

administrators, audited departments' cooperation with an internal auditing team, competency of the internal auditing team, officials' cooperation, independence in detecting risks, interest of officials, independence of the internal auditing department, promotion prospects and personal independence. Factors relating to the independence of internal audit working should be addressed urgently as it is the primary cause of the failure to prevent, detect and deter common risks specifically fraud and corruption risks.

4.2 The interview findings

Analysis of the qualitative data from the 6 volunteer interviewees reveals three primary themes: sufficiency of an internal auditing team's training; risks in relation to internal control and auditing systems; and overall effectiveness of internal auditing mechanisms in detecting and deterring risks. Firstly in relation to training, interviewees reported that they have little experience in internal audit work and would like more training particularly in audit techniques both general and specific (fraud and corruption). Their lack of training indicates the lack of competence revealed by the questionnaire responses. Their lack of training suggests deficiencies in the training received in a Bachelor degree in accounting.

Interviewees categorised common risks into three primary types: unintentional risk from errors in officials' workings, risks from intentional violations of internal control system, and risks from intentional fraud and corruption wrongdoings. Mistakes in officials' working often arises from their inattention (checking their tasks before sending to other procedures) or from their lack of familiarity with their local government operational systems and associated laws and regulations. According to the interviewees, such unintentional risks are ultimately associated with the use of political patronage in North Thai local governments, a system which allows recruitment of officials without checks of their qualifications and competence. The political patronage system does not deter intentional violation of internal control systems but ensures that violators will not be censured because administrators ensure poor implementation of internal control systems. Violations mainly consist of entering data or accessing information without permission; not following the operational procedures of local governments; and commonly buying supplies and equipment from familiar vendors without a formal procurement processes (Albrecht et al., 2006; Singleton et al., 2006; Sardan, 1999). This is the crucial flaw that allows illegal transgressions that avoid the internal control systems. As one interviewee said, "*Local governments have not applied internal control systems in their organizations ... administrators and their followers [use] gaps in regulations to take those benefits*".

Intentional fraud and corruption wrongdoings are the most dangerous risks in Northern Thai local governments. While laws and regulations exist to deal with perpetrators and offenders,

political administrators and their factions escape those laws and regulations because they use their power to change regulations and to avoid being punished. As one interviewee said “... *used internal control and auditing guidance of the Comptroller General’s Department, Office of The Auditor General of Thailand and Department of Local Administration, but not full version ...* [so that] *this guidance has not covered all common risks specifically fraud and corruption risks*”. Examples given by the interviewees of such wrongdoings include setting up dummy companies to bid for official projects which are then awarded to the dummy companies, transforming an expenditure budget to other budget categories to access the benefits, and avoiding inspection by committees by bribery of those committees. As internal auditors, the interviewees are aware of these wrongdoings but do not have the independence or power to thwart these activities.

Importantly, interviewees said that “*the Office of The Auditor General of Thailand (OAG) has never used the results of internal auditing to assess the overall environment and internal control systems of Thai local government before testing the reports received from the local governments*”. This negligence of the OAG and associated regulatory entities can destroy the morale of the internal auditing teams. Internally, North Thai local government administrators have used their powers to deflect internal audit workings because of their fraud and corruption wrongdoings. Administrators have not accepted the results of internal auditing reports and, therefore, have not implemented improved internal control systems. Internal auditors should be able to expect the central authority, OAG, to audit local governments but, as indicated by the interviewees, it fails to do so. This lack of oversight compounds the lack of independence of the internal auditing teams to determine the scope of auditing and to not have their internal auditing reports distorted by administrators. The lack of oversight by the OAG also allows administrators to corrupt internal auditors as interviewees claim: “*Internal auditors might sometimes be pulled to become their faction on wrongdoing by administrators’ black power to command; so internal auditors have eventually become their instrument to help fraud and corruption wrongdoing*”.

5. Conclusions and Recommendations

The causes of the ineffectiveness of internal auditing mechanisms in preventing, detecting and deterring common risks are the limited scope of the auditing processes and insufficient safeguards of Northern Thai local government internal control systems. The effect of this poor implementation of internal control systems has led to the generation of common risks in Northern Thai local governments without legal culpability. Poor implementation is accompanied by lack of cooperation from officials so that audit evidence is difficult to find. The lack of support from administrators has impacted members of the internal auditing teams in terms of their career

prospects and professional standing as well as their remuneration which in turn impacts their motivation. The lack of competency of internal auditors on entering the profession in local government does not provide them with the skills both to circumvent the obstacles to effective detection and deterrence of risks and to learn from their experience in local government particularly in relation to fraud and corruption risks.

This situation suggests the need to persuade all local government officials of the importance of internal control systems particularly internal auditing mechanisms so that they appropriately implement those systems (Takahiro & Jia, 2012; Sawalqa & Qtish, 2012; Cressey, 2011; Khoury, 2011). Accompanying this should be training to improve the competency of local government auditing teams especially in audit techniques for local government (Sawalqa & Qtish, 2012; Khoury, 2011; Pickett, 2004; Kongrunchok, 2009). Because of the corruption in local government, that training should include training in IT auditing, and investigative or forensic auditing (Spekle, Elten & Kruis, 2007; Coze, 2005; Allegrini & D'Onza, 2003). Numbers of internal auditors should reflect the size and workload of Thai local governments (Mihaela & Lulian, 2012; Schelker & Eichenberger, 2010).

The situation in Northern Thai local government has obviously influenced and overwhelmed the behaviour of many individuals employed in local government such that these public officers have absorbed both ethical and unethical behaviours. The interview data suggests that the unethical behaviour is more prevalent among administrators although the interviewees report that some internal auditors have been drawn to the "dark powers". The psychological incentive for fraud contains three elements: perceived incentives and pressures; perceived knowledge and opportunity; and perceived attitudes and rationalization (Cressey, 2011; Albrecht, et al., 2006). Knowledge and opportunity is provided by the ineffective internal control systems in Thai local governments. Pressures are mostly linked to the financial needs of individuals. Financial needs of internal auditors in terms of promotion prospects and remuneration has been used as pressure by administrators to get internal auditors to overlook their wrongdoings. These pressures are compounded by the corrupt attitudes of local government administrators and officials of oversight bodies, at the same time internal auditors need to have survived by conducting something akin to moral disengagement although they have broken internal auditing ethical standards. Bandura's theory suggests that they would be able to engage in immoral conduct without distress.

Therefore, administrators and others are able to avoid the internal control systems and internal audit working of the internal auditing team so that intentional violations certainly occur. Similarly, fraud and corruption also relates to power: administrators use their influence and power

to seamlessly conduct fraud and corruption wrongdoings as well as their powers have been employed to change regulations to avoid laws.

There has been a change from the 1992 COSO's Internal Control–Integrated Framework to the 2013 Updated COSO's Internal Control–Integrated Framework in Thailand. It would be interesting to examine the transitional stages of the change to find the impact of the transition. Future research into improvements in internal control and auditing systems should reveal factors and methods that could increase the effectiveness in preventing, deterring and detecting common risks especially illegal risks.

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