INTERNAL AND EXTERNAL AUDITORS RESPONSIBILITIES AND RELATIONSHIPS WITH AUDIT COMMITTEES IN TWO ENGLISH PUBLIC SECTOR SETTINGS

Karim Hegazy *, Anne Stafford **

* Corresponding author, College of Business, Zayed University, Dubai, the UAE
Contact details: College of Business, Zayed University, Academy City, P.O. Box 19282 Dubai, the UAE
** Alliance Manchester Business School, The University of Manchester, the UK

1. INTRODUCTION

This study examines the changing role of public sector oversight in the UK. It focuses on the role of internal and external auditors and their relationship with the audit committee in two distinct public sector environments. First introduced by the National Audit Act in 1983, public sector auditing plays a major role in effective public sector governance which encompasses the policies, processes, and structures used by an organisation to direct and control its activities, to achieve its...
objectives, and to protect the interests of its diverse stakeholder groups ethically (CIIA, 2020). To date public sector auditing has not been widely examined and "researchers in accounting have not been responsive to the problems and opportunities associated with developments in public sector accounting" (Hay & Cordery, 2018; O'Leary, 2015; Broadbent & Guthrie, 2008; Christopher, 2010; Goddard, 2010) even though spending on public sector services is immense. Furthermore, the public sector has complex processes, structures, and requirements where projects are often deemed more complex mainly providing explanations about the stewardship of public money and how it has been used in offering quality services, given the interest of the multiple stakeholders with various legitimate but often conflicting accountability expectations (Freeman & Evan, 1990; Ball, Grubnic, & Birchall, 2014). For instance, transparency and due process requirements applicable to the public sector exceed corporate requirements and all procedures and activities must be performed in a transparent manner. A further example of the complexity and complexity of financial data which is extended in the public sector as value for money (VFM) auditing or monitoring of the three E's (economy, efficiency, and effectiveness).

In recent years, the UK public sector, in general, has seen significant changes as the new public management (NPM) ideology has driven a shift from a traditional public administration to a "management culture, in the process emphasising the centrality of the 'customer' and accountability for results" (Aristovnik & Seljak, 2009). NPM elements include the use of private sector management styles, hands-on top management, formal measurable standards and measurement of performance, and the unbundling of the public sector into corporatized business-like units and entities (Hood, 1991, 1995) geared towards pushing for managerialism rather than a more traditional public administration. An example of the effect of the NPM ideology, which also highlights the change in public administration, can be clearly seen with public sector audit. Changes have been evident in the public sector over the last few years (Van Schendelen, 2012), with an increased focus on the accountability, effectiveness, and efficiency of its services (Van Gansbergh, 2005). Citizens are demanding more transparency and better services, while resources are growing at a slower pace. This presents a unique set of risks for the public sector. As public sector organisations do not have the same built-in performance and accountability measures as the private sector (Jarrar & Schiuma, 2007) additional accountability structures, such as internal auditors (IAs), can add significant value. However, to address this need, public sector IAs should be sufficiently capable and efficient to provide the required level of assistance. Despite the increasing importance of IA, studies on the value-added of having an IA function in an institution, especially in the public sector, are limited due to the political and economic environment of most public sectors and recent developments in the area (Brierley, El-Nafabi, & Gwilliam, 2001; Getie Mihret & Wondim Yismaw, 2007; Alzeban & Gwilliam, 2014). In 2015 the audit commission, which used to undertake the majority of external audits for public sector organisations, was disbanded by transferring the work to private sector companies. The aim was to bring the public sector audit regime into line with the private sector and mirror that of the private audit. Since 2015 the Public Sector Audit Appointments (PSAA) is responsible for appointing auditors to principal local government and police bodies, for setting audit fees, and for deciding the certification of housing benefit subsidy claims.

Thus, given the wider remit of the public sector and during these times of changes, the roles, and responsibilities of the audit committee (AC), seen as a central pillar of effective corporate governance (CG), have become increasingly demanding and scrutinized and calls for interactions with other relevant parties (FRC, 2018). While today’s AC is seen as in the best position to provide effective oversight of the performance, independence, and objectivity of the external auditor (EA), a high-quality audit is also required. The AC is also considered an important tool for increasing the organisational status and independence of the IA function to provide internal audit oversight (CIIA, 2020). Although auditees may influence the IA's effectiveness, IA-EA relationships have largely gone underexamined in a public sector setting (Postula, Irodenko, & Dubel, 2020). Moreover, central regions and key organisational settings (e.g., not-for-profit organisations) have largely been absent in prior IA research (Korb, Elbardan, & Halabi, 2020).

This study provides evidence on the role and job of scrutiny and oversight in public services by examining the role of the IA and EA and their relationship with the AC in two distinct public sector environments during the time of constant developments within the auditing arena (O’Leary, 2015). The study is also motivated by the paucity of studies that examine public sector governance structures and mechanisms in comparison to private sector CG research (Broadbent & Guthrie, 2008; Christopher, 2010). Thus, the research question can be formulated as follows:

What are the internal and external auditors' roles and responsibilities and their relationship with the audit committee in two distinct UK public sector environments?

This study takes a qualitative case study approach, based on semi-structured interviews, documentation reviews, and AC meeting observations, which enables information to be obtained from within organisations. This study extends previous work and makes an original contribution to the construction of new knowledge by providing evidence from two distinct public sector environments with differing histories, characteristics, and processes.

The paper finds a good triangulation within the roles of the IA, EA, and AC. Whilst the ACs often rely on the IAs’ work, examining internal controls and risk management arrangements, the AC provides the IA with more credibility and teeth within the organisation. However, there were some contradicting findings in terms of the IAs' appointment and the professional qualifications of...
its members, which raises serious concerns about the IAs' experience in LAs and whether they are fully equipped to fulfil their role efficiently. The study further finds that establishing a good relationship between the EA and AC is significant as the AC draws on the advice of the EA given his wider financial experience and more flexible skills base. Another interesting finding is the closeness found between organisations and the EA especially in local authorities (LAs). This implies whether there will be a conflict of interest in the form of organisations having to pay the EAs fees after the abolition of the audit commission, which might hinder the characteristics of independence and objectivity. This is also due to the novelty of ACs especially in LAs who are still in a learning process and who are constantly being offered training on their roles and expectations by the EA. Furthermore, the findings confirm that having a good relation and collaboration between the IA and EA leads to a more effective audit based on a clearer understanding of the respective audit roles and requirements and a better-informed dialogue with the AC on the risks facing the organisation.

The paper proceeds as follows. Section 2 reviews the relevant literature and theoretical framework used. Then Section 3 presents the main internal and external audit requirements found in two distinct English public sector environments. Section 4 presents the research methodology used. Section 5 presents the research findings followed by a discussion in Section 6 and conclusion in Section 7.

2. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

According to the paradigm of corporate governance developed by the Institute of Internal Auditors (IIA), an effective IA is one of the four foundations of corporate governance along with management, the AC, and the external auditor (CIIA, 2020). The IA is an independent, objective assurance and consulting activity designed to add value which is critical for uncovering and preventing fraud in institutions (Abbott, Parker & Peter, 2010). The IA function has been made mandatory in private and public sector organisations due to the legal and regulatory reforms aimed at promoting better governance after the financial scandals of the early 2000s (Carcello et al., 2020; Sarens, De Beelde, & Everaert, 2009; Gramling, Maletta, Schneider, & Church, 2004). CG guidelines and quotation rules (Blue Ribbon Committee, 1999; FRC, 2003, 2018) explicitly recognize the governance role played by ACs in supervising and supporting the relationship between management, IAs, and EAs. Stewart and Subramaniam (2010) assert that in recent years, ACs have undertaken an important governance role in coordinating and monitoring the relationship between managers, IA, and EAs. Nevertheless, IAs and their relationship with the AC remain a neglected area of research (Gendron & Bédard, 2006; Roussey, 2013). Little has been written about the practice of the IA (Zain & Subramaniam, 2007; Davies, 2009; Roussey, 2013) and its relationship with the AC especially in an environment other than the private sector (Koth et al., 2020), even though engaging in open and transparent relationships with the AC enhances the IA's effectiveness within the organisation (Beasley, Carcello, Hermannsson, & Neal, 2009). Moreover, the AC is required to develop and implement a policy on the engagement of the EA to supply non-audit services, considering relevant ethical guidance by the EA. In addition, the AC is required to report to the board, identifying any matters in respect of which it considers that action or improvement is needed (FRC, 2018). Therefore, maintaining a good relationship with the EA is crucial for an effective working AC, as the AC also often relies on the EA's advice and expertise.

2.1. Internal auditors and audit committees

A considerable amount of literature has been published on different elements regarding the relationship of the IA and AC (Eulerich, Kremin, & Wood, 2019; Beasley et al., 2009; Sarens et al., 2009; Zaman & Sarens, 2013; Stewart & Subramaniam, 2010; Lenz & Hahn, 2015). This is of importance as the AC can often act as a mediator and supporter of the IA in organisations (Turley & Zaman, 2007) and has a role to assess the performance of the IA function, appoint heads of IA, support and promote the audit function within organisations (Davies, 2009), and strengthen the independence of the IA (CIIA, 2020). Consequently, the IA's familiarity in firms with risk management systems puts them in a unique position for providing an advisory, supportive, and facilitative role. Thus, they can offer great help and comfort to ACs to improve internal control and risk management aspects of companies (Sarens et al., 2009). In the same vein, O'Leary and Stewart (2007) shed light on the AC as an effective means of strengthening the position of the IA audit function by providing a supportive environment (Gramling et al., 2004) and Alzeban (2015) argues that the interaction of the IA function with the AC can establish a power base for the IA.

Research on the expectation and contributions of each other's role in the CG mosaic was also extensively studied (Sarens et al., 2009). These included the AC involvement in process issues (Gendron, Bédard, & Gosselin, 2004), the role of AC in negotiating resources for the IA function (Abbott et al., 2010), and the association between AC characteristics and disclosure and remediation of internal control weaknesses (Zhang, Zhou, & Zhou, 2007). These studies show that an IA function that receives strong support from the AC is likely to be more objective and powerful in the implementation of controls, thus allowing the IA to fulfil its role more sufficiently. The most discussed procedural however was found to be the meetings between the AC and IA (Gendron et al., 2004). ACs and IAs often engage in informal interactions in addition to formal pre-scheduled meetings. The establishment of an informal link between the AC and IA head was seen to improve the overall motivation of the IAs in carrying out their duties and their credibility to the AC chair as a valuable unit of the firm (Zaman & Sarens, 2013; Coetzee, van Rensburg, & Schellhass, 2016; Asiedu & Deffor, 2017).

Most studies though focused on the private sector. The limited prior public sector research has largely followed the patterns set out by researchers examining the relationships between all three parties in a private sector context, discussing IA public
sector capabilities, their roles, composition, and effectiveness. Roussy (2013) found that the IA has two roles: a protector and helper role. On the one side, the IA has the role of protecting the top managers against any pitfalls or obstacles and keeping the secrets besides supporting the organisational performance and providing guidance when new rules are implemented in a helper role. Thus, having a close relationship between the AC and IA improves the governance capabilities of both.

2.2. External auditors and audit committees

The AC relationship with the EA is not so close, being more formal (the Sarbanes-Oxley Act of 2002; FRC, 2018) than the AC relationship with the IA. Similarly, several studies have considered the role of the AC in appointing and removing the EA (Carcello & Neal, 2000, 2003; Krishnan, 2005). The AC often relies on the work done by the EA in terms of auditing and testing of controls. Regarding the AC and EA role, the AC has the “ultimate authority and responsibility to select, evaluate, and where appropriate, dismiss the outside auditor” (Blue Ribbon Committee, 1999, p. 14). Several associations between the AC, board characteristics, and auditor dismissal decisions (i.e., timing and successor auditor choice) have also been investigated (Chen & Zhou, 2007; Compernolle, 2018).

The AC is now also responsible for the appointment, compensation, oversight, retention, and dismissal of EAs. Auditor dismissals could occur as a response to the issuance of a qualified opinion, a going concern opinion, high audit fees, changes in client characteristics, and auditor effectiveness (Carcello & Neal, 2003; Hudaib & Cooke, 2005). Presumably, some dismissals are aimed at punishing auditors and/or seeking a more favourable audit opinion while others have the objective of improving the audit service. It is clear nonetheless, that there is a rarity of studies examining the EA roles and their relationship with the AC in a public sector context. Especially, with the abolition of the audit commission, such relationship will increase in significance and there is a need to shed further light on their interactions from within organisations — as is the case in this study.

Thus, to recap, AC members depend upon both internal and external auditors in evaluating the effectiveness of internal control and financial reporting (Beasley et al., 2009). Therefore, having a good relationship with both is significant to the effective monitoring and challenging role ACs provide (Goodwin, 2004). However, the scant existing literature on examining such roles and relationships in a public sector context implies a need for further exploration research in different organisational and institutional contexts (Kotb et al., 2020).

2.3. Theoretical framework

Agency theory (AT) has been the overriding theory in CG studies and the predominant paradigm in studies concerning bureaucracy and public administration in the public sector (Schillelens & Busuioc, 2015; Gailmard, 2014). It has been used to explain issues relating to financial reporting and auditing in previous studies (Bradbury & Scott, 2015). In simple terms, the AT portrays a contract between a principal (body or institution) who delegates powers to an agent to carry out the job. Agents, who often are assumed may operate in their best interest, are usually subject to the oversight and controls by the principal or other third parties (Bovens, 2007; Schillelens, 2013). IAs generally report to those who are strongly associated with “agents” (i.e., audit committee members) or to the agents themselves (e.g., top managers) (Burnett, Norman, & Sycara, 2011). Indeed, the IA, who is considered the first line of defence against fraud (Rezaee & Lander, 1993), must inform the AC about any irregularities or fraudulent activities of which he/she becomes aware. Conversely, IAs are more deeply submerged in organisational politics and are more often threatened by symbolic sanctions.

Thus, agency theory presents the foundation for explaining the functions assigned to IA since it is the IA that assures the management (Adams, 1994). Nevertheless, there has been a continued critique of its appropriateness in public sector institutions. The two main assumptions of AT, mainly the goal conflict between an agent and principal and information asymmetries, are said to vary as opposed to being constant, leading to the need to adjust such in a variety of institutional settings and organizational contexts (Meier & Krause, 2003). The behavioural assumptions of PA will not often hold as agents (public sector organisations) are guardians/stewards who are motivated to do their jobs and tied to an institutionalised mission that is likely to transcend their self-interest (Schillelens, 2013).

Thus, this paper argues that some of the initial assumptions of AT in institutional arrangements need to be revisited, relaxed, or dispensed of and extended explanations provided. There is a need to add additional factors to the analysis such as considering the wider and more complex accountability relationships and intricacies and auditing arrangements found in public sector various jurisdictions. Much of this demand has been because of public expectations in reaction to corporate scandals.

The institutional theory postulates that a corporation’s management and control arrangement tend to go with public expectations and has been powerful in explaining the adoption of innovations by institutionalised organisations and has been used extensively in public sector accounting (Cohen, Krishnamoorthy, & Wright, 2007, 2008; Ezzamel, Robson, Stapleton, & McLean, 2007; Jacobs, 2012) and how existing structures fulfil ritualistic roles to help legitimize the interaction among various participants of the organisation. For example, ACs may be coerced into becoming similar through regulation, following the best practice model, or by mimicking other organisations.

To be better equipped to understand and analyse the incentives and motivations that shape the different behaviour of agents the empirics in this study also consider the concept of decoupling as part of Institutional theory. Decoupling is one of the main coping devices by which organisations navigate complex institutional fields (Crilly, Zollo, & Hansen, 2012; Lok, 2010; Greenwood, Raynard, Kodeih, Micelotta, & Louvshury, 2011). As a form of loose coupling, decoupling occurs when organisations adopt a legitimating program or policy
and at the same time fail to implement some or all the requisite practices expected to go with the adoption, and it is typically used by organisations as a means of reconciling conflicting institutional demands (Meyer & Rowan, 1977). Since organisations “face institutional complexity whenever they confront incompatible prescriptions from multiple institutional logics” (Greenwood et al., 2011, p. 318), decoupling serves as a particularly viable response in such institutional fields. Moreover, decoupling is widely considered to be a strategic response by which organisations purposefully “avoid” conforming to institutional pressures by hiding “nonconformity behind a facade of acquiescence” (Oliver, 1991, p. 154). As such, it fits well with the extant strategic understanding of institutional complexity: the conflicting demands in such environments are imposed upon organisations by various institutional constituents that adhere to different institutional logics.

In an auditing setting, this implies that the IA and IA roles and their relationship may only be loosely coupled with the effectiveness because their roles can be ceremonial/ritualistic and only there for external legitimacy seeking purposes (ceremonial conformity (Spira, 2002, 2003). Thus, the IA and EA roles and relationships may act to conform to pressures from stakeholders or triggered by power struggles (Modell, 2009a, 2009b), tend over time to become similar to others in the same sector. However, “absorb changes without necessarily changing their behaviour” (Marriott, Mellett, & Macniven, 2011). Some governance activities, processes, and structures may be driven by a desire to earn legitimacy, hence are ceremonial in serving as a symbol of effective oversight (Nor-Aziah & Scapens, 2007; Modell, 2009a, 2009b).

This study argues that the application of the theoretical assumptions of AT to the public sector is not sufficient. It agrees with the study by Lan and Heracleous (2010) who found that AT is only partially applicable to relationships between governments and not-for-profit organisations and that institutionalization and its different streams, would be more suitable to understand the adoption of CG processes and structures in public sector organizations. A single theory should not be expected to explain results in a study (Gendron, 2009) and in fact, diverse theories can be employed simultaneously to describe a given reality (Beasley et al., 2009; Cohen, Krishnamoorthy, & Wright, 2010).

3. BACKGROUND ON UK PUBLIC SECTOR AUDIT ENVIRONMENT

This study investigates the roles and relationships between the AC, IA, and EA in two distinct public sector environments, namely foundation trusts (FTs) and local authorities (LAs). The choice was made on the two largest public-sector areas with distinct histories and characteristics, and which have been undergoing significant changes especially in terms of public audit and governance. This would offer suitable evidence to examine such relationships.

Within health, the National Health Services (NHS) FTs are a relatively new organisational form and represent a good example of the application of NPM techniques to the public sector. FTs were created and set up as separate and independent legal entities. Through their centralized top-down management structure, their governance model and structure are the closest in similarity to a private sector CG model. On the other hand, LAs have a long-established history dating back in some instances to Anglo-Saxon times. They, therefore, bring a wealth of tradition and piecemeal organisational structural change which makes it hard to impose governance new structures and regulations. LAs, which are political in nature, are created by Acts of Parliament and are set up as statutory autonomous bodies, independently elected, and can raise taxes locally.

3.1. Internal Auditing

A professional, independent, and objective internal audit service is one of the key elements of good governance, as recognised throughout the UK public sector (CIPFA et al., 2017). The objective of the public sector internal audit standards is to set out the basic principles for carrying out the IA work and establish a framework for providing IA services in the UK public sector (CIPFA et al., 2017), and to strive to have improved organisational processes and operations to provide assurance on risk management arrangements, governance, financial and internal control. Boards should be advised by an independent AC chaired by non-executive directors (NED) and an IA service operating in accordance with the government IA standards.

The NHS internal audit standards (Department of Health, 2011) defines the nature of the IA within the NHS and sets the basic principles for carrying out the IA assurance and consulting role which includes giving an opinion on the overall adequacy and effectiveness of the organisation’s framework of governance, risk management and internal controls in NHS organisations. These roles are required to be performed in accordance with requirements from the code of ethics which include integrity, objectivity, confidentiality, and competency, and mainly look at CG arrangements rather than performance. Moreover, the framework states, that the head of IA must establish effective communication with the AC chair with free and unfettered access and to inform the board on whether they have adequate assurances on the design and operation of the systems in place to mitigate any risks.

For local government, the IA is an ongoing function reporting to the council at least once a year and undertaken to test the continuing existence and adequacy of internal controls resulting in an assurance report designed to improve the effectiveness and efficiency of the activities and operating procedures of the council’s internal controls (CIPFA et al., 2017). There is no requirement for the IA to be professionally qualified, but essential competencies to be sought in any IA include an understanding of basic accounting processes. It is however up to the LA to arrange for the IA either by appointment of an external IA firm or from in-house members. However, by choosing either option the appointment should comply with statutory requirements and IA standards, and ethical policies. It is beneficial for an IA to have awareness of risk management issues and an understanding of accounting requirements of the legal framework and powers of local councils (CIPFA, 2013). Moreover, it is essential that the IA function is sufficiently independent of the other
financial controls and procedures of the council which are the subject of review. To ensure the objectivity of IAs, it is now being recommended that the IA should hierarchically not be positioned underparts of the organisation that are themselves subject to internal audit scrutiny, thus have a reporting line that makes it independent of management.

3.2. External auditing

Public sector auditing takes a distinct approach and mainly focuses on VFM that can form a basis questioning those responsible and establishing future priorities besides assisting decision-makers in how to promote effectiveness (degree of objectives achieved) (Glynne, 1985; Parker & Guthrie, 1993). In 2015 the audit commission (set up 1983) was disbanded by transferring the work to private sector companies by outsourcing contracts aiming for more decentralization by organisations appointing their own auditors, increasing transparency to the public, ensuring high standards of the audit by effective and transparent regulation of public audit, and decreasing the audit fees by being more competitive. For the NHS, Monitor (now called NHS Improvement), the regulator has set out an audit code, which prescribes the way in which the EAs are to carry out their functions and reporting as set out in the National Health Service Act 2006. Besides giving an opinion on the financial position of organisations which implies the need to be independent, EA requirements in the NHS are more complex and geared towards reducing costs and burdens and looking at key areas of financial resilience. Moreover, it includes providing an opinion on whether organisations are performing effectively and responding to budget cuts during these times of austerity well, without affecting the quality of their services. In addition, auditing in the NHS includes a responsibility around quality accounts and giving an opinion on whether there are proper arrangements for securing economy, efficiency, and effectiveness in the use of the available resources in line with their annual budget and medium-term financial strategy (National Audit Office & Office of Government Commerce, 2000).

For local government, the audit commission issued a separate code of audit practice, primarily to reflect the increasingly divergent accounting, CG, and performance management frameworks. Several principles also go further than private-sector codes such as reviews of compliance, reporting on the use of resources, VFM, certification, and audit reports (National Audit Office & Office of Government Commerce, 2000).

4. RESEARCH METHODOLOGY

This research is part of a larger study and draws on an exploratory case study approach which includes semi-structured interviews, document reviews, and observation of AC meetings. A qualitative approach was chosen for this study as it assists in understanding and investigating the roles of the IA and EA and their relationship with the AC by providing evidence and getting deep insights from within two public sector environments. These are beneficial when engaging with practice (Yin, 2003) and offer better descriptions of the phenomenon because they permit details naturally suppressed in studies of large samples (Patton, 2002). One of the important aspects of qualitative and interpretive research is a well-kept balance between rigor and openness (Ahrens & Chapman, 2006). Openness can be achieved through methodological flexibility and multivocality, which, according to Gendron (2009), are not independent of one another. Methodological flexibility allows for the adoption of data collection and analysis according to the emergence of significant trends and patterns from the data.

As this study is part of a wider study and based on results of compliance testing performed, four FTs and four LAs reflecting both high and low levels of compliance were chosen for further investigation. This was later reduced to two FTs and two LAs based on the organisations’ willingness to be interviewed, the research objectives, the type of the FT, the political structure of the LA, and accessibility of the organisation chosen. Table 1 presents the main characteristics of the four cases chosen at the time of the study and for anonymization purposes, the FTs chosen were named North and South, while the LAs were named East and West. In total and for the purpose of this study 26 interviews were carried out in four public sector organisations between 2013 and 2015. Interviews were undertaken with finance directors, internal and external auditors, audit committee chair, and members of all cases. Due to privacy requirements in the health sector, the AC chairs were asked for permission to attend AC meetings on an observation-only basis. In contrast in local government, AC meetings were open to the public except for any restricted business, confidential nature, and minutes and some working papers are made publicly available on websites.

Semi-structured interviews were predominantly used to gain insights from within organisations on the interaction between the AC, IA, and EA in practice and helped to uncover any non-visible data which may be due to limitations of secondary data. For example, interviews asked about the role and responsibilities of the interviewee, follow-up, and confirmation of information coming out of previous board meetings via minutes and agendas to check whether they have been implemented or not. Furthermore, observations provided supplementary insights and verifications of participants’ claims as well as confirmation of documentary reviews (McKernan, 2013). Examining secondary data along with the interviews and meeting observations was used as part of a triangulation process to compare and interpret information and reveal any contrasting views between interviewees’ responses and written records. Once the data had been collected, collated, and transcribed, they were manually coded using key theoretical constructs (Ahrens & Dent, 1998). Patterns and exceptions were identified in the coded data and the results were documented once the process was complete.
5. RESEARCH FINDINGS

5.1. AC relationship with the IA

In public sector organisations, the main purpose of the IA is to review whether the financial systems, governance standards and assurance, risk management arrangements, and financial controls and operating procedures are effective.

“The IA gives an opinion on the FTs systems of governance, risk management, and internal control but I see their broader role in the organisation managing itself better to have better governance, better control, and risk management” (FT member).

The findings further provide evidence of the cycle the IAs go through to present their work to the AC who in turn reviews and scrutinises their work. The IA usually reports through the management route first, which means that the personnel responsible from the management side (usually the finance director or equivalent) meets monthly with the head of IA to go through the progress of the IA plan and any emerging issues before meeting with the AC. However, the IA also has a special route to report up through the AC on what has and is being done and how VFM is being delivered. This link is of significance as it illustrates that the AC is kept up to date and provides the AC with constant assurances on happenings in lower levels of the organisation. The IA reports, which usually consist of set pieces and where the year-end document is a set of accounts, which pictures measures of the IA performance and comprises the IA’s annual audit opinion on the internal controls of the organisation, are then presented in a special AC meeting as head of IA on a yearly basis. The AC then in turn reviews the IA’s work and monitors the progress against recommendations of reports (progress against IA plan or outcome from IA reports) provided quarterly by the IA. Moreover, the AC also must get a sign-off from the IA in terms of reasonable assurances that the internal controls are working effectively and that the major risks are within an acceptable level, to be able to certify the integrity of the accounts in the organisation. These findings confirm a good interaction between the work of the IA and AC and ensure there is the constant awareness of the ongoing work of the IA team by the AC, which is in line with best practice ideas and formal guidelines.

The research findings further confirm that there is a close, easy, relaxed, and good working relationship between the IA and AC as the IA is regarded as "the day-to-day eyes and ears of the operation of the trust". Although most of the IA work is done and reported first to management the IA can get in touch with the AC at any time.

“There is a quite easy way of communicating in that respect, so she knows she can always speak to me as chair. Likewise, I know that if I need to pop in this morning without an appointment, I can do so” (AC chair).

“I find the relationship to the IA extremely good because the IA understands the business and the work, he does have a whole range of stuff and a whole range of powers. IA is the most interesting part of the work on the AC” (AC member).

“I have an incredibly positive relationship with the chair, and I see it as particularly important. As I report independently, I can do that in a public
committee that gives me a link through to the political side of the business” (IA member).

An FT AC chair further reinforces that he finds the IA people experienced and sensitive to the fact that this is a hospital (trust) whilst demanding the best in terms of probity. The importance of the close AC and IA relationship also lies in the fact the combined work in terms of setting the audit plan. Therefore, it is of significance that the AC and IA maintain integrity and competency when dealing with and relying on each other’s work. The findings however find that the appointment of the IA does not follow a certain pattern. In one instance the IAs were found to be from in-house, in another, they were externally appointed. Nevertheless, in both instances, they are bound by a code of ethics which includes maintaining integrity, objectivity, confidentiality, and competency when performing their role. The latter focuses more on management style issues, governance arrangements, and the internal control environment.

The research, similarly, to findings from the private sector (Gramling et al., 2004; Sarens et al., 2009), further provides evidence that the AC contributes to the role of the IA as it adds more credibility to their work and gives them “more teeth” in the organisation. The AC is there to challenge and scrutinize the work of the IA as well as being there to help them with any authority matters. “Often issues and what we say may not be taken notice of, so the AC can help by stepping in and adding weight to what we are saying” (IA member).

Alzeban (2015) supports this view by arguing that the interaction of the IA function with the AC can establish a power base for the IA with the AC involvement in process issues and in negotiating resources for the IA function to operate effectively and strengthen their credibility. However, important to stress is that the IAs do not consider themselves that they work for the AC: “Previously the AC would actually decide the IA work program which is not the way it should actually work” (IA member).

This quote illustrates that there are continuous developments within the understanding of the IA roles and their interaction with the AC in line with best-practice processes. On another note, the interviewees agree that AC members sometimes feel the need to be protected by the IA too as they are aware that they only have access to information filtered by managers of the organisation. However, in some instances, they may want additional insider information accessible only by the IA. Thus, the AC relies on the IA to warn them of issues that managers wish to conceal but also to direct the IA to focus on major risks facing the organisation. Consequently, for the AC to be able to fulfil its monitoring and scrutinizing role effectively it needs to have a clear and transparent relationship with the IA as both rely on each other’s help and advice enabling them to perform their prescribed roles efficiently.

Thus, maintaining a good relationship between the AC and IA is significant as they both often rely on the work of one another which improves the governance capabilities of both (Postula et al., 2020; Zaman & Sarens, 2013; O’Leary & Stewart, 2007; Roussy, 2013). Although the AC monitors and scrutinizes the work of the IA, the AC in its authoritative role provides the IA with more comfort and credibility within FTs and IAs. Considering the symbiotic relationship between the AC and the IA function, their effectiveness and performance are inevitably interrelated (Sarens et al., 2009; Zaman & Sarens, 2013).

5.2. AC relationship with the EA

The interviewees confirm that the EA has a much wider remit to cover in public sector organisations. Unlike the private sector where EAs are required to give an opinion on whether the accounts show a true and fair view and confirm that the company is a going concern, auditing in the public sector goes beyond that.

“In the FT sector, there is responsibility around quality accounts which is quite specific. There is also a responsibility on giving an opinion on whether there are proper arrangements for securing economy, efficiency and effectiveness in the use of the available resources” (AC chair).

“In local government aspects as maintaining financial sustainability, waste and recycling targets, and maintaining budgets on expenditure on Children’s and Education and Housing Services which all relate to improving VFM are aspects EA have to look at” (EA member).

These aspects are all of significance to the various stakeholders with legitimate vested interests such as members, patients, or the public who demand high-quality care and services and transparency in reporting.

The demise of the audit commission has led to the appointment of new private firms. The interviewees believe that having a balance on the EA team between old members (from the audit commission), given their knowledge and experience about the structures and processes of the organisation and the new EA members (from private firms), with fresh and useful thoughts, are expected to be beneficial to the organisation. However, there will be requirements for rotation in a few years, as in the private sector, to comply with the independence and objective elements auditors possess. It remains to be seen whether private firms, with little experience of the structures and processes of public sector institutions, are well suited to take over the role of the audit commission, during the continuous changes in governance arrangements, the UK public sector is undergoing. The research findings found that unlike with the IA, the AC does not meet the EA as frequently because of the different natures of both their jobs. In public organisations, the AC relationship with the EA is about the latter being able to give the AC members assurance that the accounts having withstood scrutiny can meet all requirements of the regulator in terms of any accounting standards and reporting requirements.

The EA relationship with the AC is being seen by some interviewees, especially in the health sector as a detached and formal relationship and being more at arm’s length. However, other interviewees especially in local government, view the relationship with the AC as an informal communication and relaxed relationship. “If they want to meet with us privately over and above the normal set periods then they can do so. And in that respect, there’s an open door for them to do that” (EA member).
These contradicting findings raise thoughts on the different environments understanding of the interaction and relationship between the EA and AC. All interviewees nevertheless strongly believe that maintaining a good relationship between the AC and the EA is crucial to having sound CG structures.

"The code of governance would always say there needs to be time for auditors and the AC to meet privately. Out of the four AC meetings a year, that would happen on three occasions. It is always important that the chair of the AC and the audit manager have each other's numbers" (FT member).

A further AC chair sees the relationship with the EA as healthy too and confirms having a good working relationship with the EA. The EA can meet with the AC chair at least once a year outside the AC. The only criticism is that it can get "cosy" when the organisation itself starts paying the EA wages after the abolition of the audit commission. “According to the master-servant relationship”, there should always be that distance between the council and the EA" (AC chair).

This point raises serious thoughts about the independence aspect of the EA which might hinder its role in terms of reporting in an objective and independent manner. More interestingly the research findings confirm such concern and find that in practice there is a crossing over in terms of responsibilities which affects the independence aspect of the EA and AC. So recently in an organisation the EA conducted a survey of the AC members’ thoughts on their role to be used as a sounding board outside of the committee to help them with any necessary training required. "I feel that the AC members are seeing that we are bringing the AC some assurances. The dialogues and questioning are there and often there are queries on our reports and the AC members want a further understanding of it. So, the AC is there to critically assess whether we are doing our work in some aspects correctly" (EA member).

A further quote by an EA raises doubts about the interaction and closeness between the AC and EA and whether the private firms have considerable experience and knowledge "If they want to meet with us privately over and above the normal set periods then they can do so. And in that respect, there’s an open door for them to do that" (EA member).

Furthermore, informal meetings often also take place to discuss relevant matters and concerns by the EA. On one hand, informal meetings are a good opportunity for the AC members to ask any questions, whereas the EA could make the committee aware of any financial or non-financial issues and raise any concerns. It is encouraged as a form of standard practice for the EA to meet alone with the AC as it provides an important opportunity for the AC to raise issues, ask questions and seek feedback from the EA without the IA or management observers being present. One example of this happening in practice was observed during an AC meeting attended. An AC chair suggested he had an informal chat with the EA to discuss several issues regarding the new auditors’ engagement as well as enquiring more about the audit approach the new private firm is planning to undertake in terms of their reporting style.

Having a relationship based on trust between the AC and EA enhances the reliability of the AC’s monitoring and scrutinizing as the AC often relies on the EA’s opinions, especially on the financial accounts. However, on the other hand, informal meetings are also often used for other purposes which suggest less independence and a crossing over in terms of AC and EA roles. As an example, the EA often holds presentations for the AC members to try and get them up to speed with any issues, emerging requirements, or regulations. This is due to the newness of the AC in public sector organisations, especially in local government. The findings further suggest that the AC are still in a learning process and are gradually improving in terms of their effectiveness and awareness.

The findings confirm a good working relationship between the AC and the EA in all organisations as they often build on each other’s work for obtaining additional assurance. Nevertheless, the findings suggest a close interaction between the AC and EA and a crossing over of responsibilities, especially in LAs, which raises questions about the independence aspects of both. It remains to be seen how such a relationship develops in the future.

5.3. Relationship between the IA, EA, and AC

For a good relationship to exist between IAs and EAs, the independence of the IA department is critical as often EAs rely on the work of IAs to do their job. The scope of work and materiality of systems and structures depend on the efficiency and effectiveness of the IA. For instance, a poorly deployed internal auditing system can lead to increased, non-value-added costs, many hours of wasted resources, and eventual breakdown of the assurance system of the institution. The research findings confirm the close relationship between the IA and EA. The IA meets around four times with the EA in informal meetings between them besides also meeting in the AC meetings. The formal as well as the informal meetings between the IA and EA are significant as the IA and EA review and often place reliance on each other’s work.

“I think it’s important to give their opinion and they need to get an understanding of the accounts, VFM, and what else is going on in the business. I can help them understand this. Equally, I rely on them to do some work rather than duplicate our work. Overall, we have a constructive relationship as we are two parts of good governance arrangement” (IA member).

Usually, the IA is aware of aspects that go on at an organisational operational level, and thus strategically the IA head has a particularly good understanding of where the organisation is heading. On the contrary, similarly as with the AC, the EA usually only has and can gain access to information he receives from managers or officers. This means he often must rely on management information provided by the IA. On the other side, the EA can also advise the IA on certain areas where some form of external expertise may be needed, e.g., in terms of management controls. Furthermore, as most of the EA’s work is around financial accounts.
If the IA can provide assurance that systems and arrangements operate effectively and there are no significant errors, then the EA can gain some comfort from that and help them with their audit approach. More importantly, having sound CG structures and internal controls in place benefits the AC in terms of its monitoring and scrutinizing role. Furthermore, the IA and EA usually consult with each other during the planning phase of individual audits that address the key financial and business systems underpinning the organisations’ accounts. To confirm with best practice arrangements, the EA is required to evaluate the work of the IA to determine its adequacy for external audit purposes (Prewitt & Erhun, 2011). However, there have been developments as the IAs now direct the EA too by requiring them to perform work on specific aspects they may need further assurances on. “It's not seen in a confrontational way but rather as more of a partnership. Nevertheless, the EA still possesses a key independent role to play in the organisation” (IA member).

This quote again raises concerns about the independent aspect of the role. Such close interaction is healthy to having sound CG arrangements within the organisation. Such informal relationships also surprised an AC chair: “I never quite understood, particularly before becoming a member of the AC how informal it is. I would have imagined that there should have been a stricter relationship between the EA and IA. But it does not really work that way. It is a very informal relationship and clearly, they have to work together a lot throughout the year”.

The findings further confirm that there may be some elements of overlap within the IAs and EAs agenda and they also may work together on particular areas if needed. An IA confirms such a view but ensures that when any collaborative work is undertaken the work balance doesn’t conflict: “The EA basically lives here as they have an own office at the council, and we see them daily. We have formal meetings with the CFO once every 6 weeks to talk about issues the EA may have or work, they must do”.

Nevertheless, important to note is that such an informal relationship also has its benefit because if any sudden issues come along such as a discovery of fraud, the IA would inform the EA straight away rather than wait for the next meeting. This would enable the EA to tackle any evident issues and risks immediately.

6. DISCUSSION

Through the lens of agency theory, the IA and EA and their relationship with the AC are part of a governance arrangement in firms to satisfy the demands for accountability and bound the contractual relationship between stakeholders and agents. Whilst the ACs often rely on the IAs' work, which predominantly examines the internal controls and risk management arrangements of the organisation, for insider or management lower-level information, which is not easily accessible, the AC provides the IA with more credibility and teeth within the organisation. The informal relation between both and the IA having unfiltered access to the AC means that the AC is constantly kept up to date on any emerging matters which improves the ACs’ scrutinizing and monitoring responsibilities. However, the AC must assess and review the IA’s performance too, which requires maintaining a balance between being professional, independent, and objective. The study also confirms the continuous developments within the IAs role and a better understanding of the IAs relationship with the AC. Historically the AC was responsible for setting the IA roles and plans which should not be the case.

There were some contradicting findings in terms of the IAs appointment and the professional qualifications of its members which contradicts some of the assumptions of AT. The flexibility in terms of appointing IAs from in-house or from outside of the organisation and having no requirement to be professionally qualified raises serious concerns about the IAs’ experience in LAs and whether they are fully equipped to fulfil their role efficiently. Due to the constant changes in the public sector, there are elements of a loosely coupled system and whether such informal interaction is healthy to having sound CG structures and processes evident in terms of absorbing changes to create legitimacy outside of the organisation.

Additionally, the study finds that maintaining a good relationship between the EA and AC is significant as the AC draws on the advice of the EA given his wider financial experience and more flexible skills base. Nevertheless, due to the wider EA responsibility in the public sector, which not only covers financials but also quality accounts in FTs and VFM in LAs, the question arises whether organisations have suitable and enough resources to cover such responsibilities. With the demise of the audit commission and the appointment of new private firms, there is a balance between old members given their knowledge and experience about the structures and processes of the organisation and the new EA members, with their fresh and useful thoughts. This raises thoughts on whether these arrangements, in terms of allowing the continuation of previous governance arrangements and personnel and just appearing to have absorbed such changes in personnel in a ceremonal way, are beneficial or whether there are elements of loosely coupled structures evident. The question also arises whether private firms, with little experience of the structures and processes of the public sector, are well suited to take over the role of the audit commission during the continuous changes the public sector is witnessing.

Another interesting finding which needs to be observed over the coming years is the closeness found between organisations and the EA especially in LAs. This implies whether there will be a conflict of interest in the form of organisations having to pay the EAs fees, which might hinder the characteristics of independence and objectivity thus contradicting AT assumptions. This is also due to the newness of ACs especially in LAs who are still in a learning process and who are constantly being offered training on their roles and expectations by the EA. Moreover, the relation between the AC and EA was found to be more of a formal and detached relation at an arm’s length in FTs, similar to private sector practices, whereas more of
an informal relationship in LAs. The issue arises about the different understanding found in both environments about the EAs and their responsibilities and raises serious questions about whether this might affect the EAs’ objective monitoring and reporting. This point is further reinstated by the EAs being located and having their own office in a LA.

Furthermore, the findings confirm that having a good relation and collaboration between the IA and EA leads to a more effective audit based on a clearer understanding of the respective audit roles and requirements and a better-informed dialogue on the risks facing the organisation. The EA can often rely on the IA to obtain any insider information and the initial testing of the internal controls performed by the IA whereas the EA can also advise the IA on certain areas where some form of external expertise may be needed. This leads to the focusing of audit effort and consequently to more useful advice to the AC. Therefore, the interrelationship between the three parties (AC, IA, and EA) is crucial for the organisation in terms of having sound and proper governance arrangements and an effective working AC which enhance the organisation and assist senior management and the AC in providing high-quality public services.

7. CONCLUSION

This study provides insights into the role of public scrutiny and oversight and examines whether governance arrangements in terms of the IA and EA roles operate effectively in two distinct public sector environments. The research is exploratory in nature and has adopted a qualitative case study. It has done so through providing evidence from the two largest UK public sector environments namely the NHS and local government. This study provides evidence on the significance of the relationship between the AC, IA, and EA which all contribute to having sound CG arrangements, governance processes, and structures in public sector organisations. Maintaining sound accountability relationships within organisations with the various stakeholders involved is a major challenge faced by public sector organisations due to the complexities involved. Nevertheless, through the ACs challenging and monitoring responsibilities, one of which is overseeing the roles of the IA and EA, ACs have a significant role in making sure standards and accountability relationships are enhanced.

The study has several contributions. First, it contributes to the claims that “researchers in accounting have not been responsive to the problems and opportunities associated with developments in public sector accounting” (Hay & Corder, 2017; O’Leary, 2015; Broadbent & Guthrie, 2008). Secondly, it adds to the scant literature on public sector auditing in a different key organisational setting especially on the IA’s effectiveness and IA-EA relationships (Postula et al., 2020; Kotb et al., 2020). Thirdly, it is one of the few studies in a public sector context that uses a qualitative study approach to gain insights from within organisations through semi-structured interviews and meeting observation on the interaction between the AC, IA, and EA in practice. Finally, from a theoretical perspective, it provides further evidence that the application of the theoretical assumptions of AT to the public sector is not sufficient and only partly provides explanations and that multiple theories can be employed simultaneously to understand the adoption of CG processes and structures in public sector organisations. Whilst the study provides evidence of having sound CG arrangements in line with agency theory characteristics, in terms of the IA and EA roles and their relationship with the AC, the relative newness of such arrangements in LAs provides some evidence of loosely coupled systems in terms of absorbing changes in a ceremonial way. Further research is to be done in the future to observe such developments and may be extended to other public sector institutional settings and organizational contexts such as in schools, universities, and central government. Such studies can also be applied and used at a national or an international level and may open the door for comparisons between public and private sector organizations or between different environments in the public sector itself.

The limitations associated with the case study approach apply to this study as critics may argue that as the findings are based on a specific context, setting and only four cases, the claimed contributions to knowledge may not pass the test of statistical generalisation; that is, they lack external validity. Moreover, as the findings are based on a specific context within space and time it cannot be guaranteed to be the same in the future for other environments and institutional settings. However, such findings can be analytically generalizable, meaning that the findings can be generalizable to similar kinds of circumstances and environments (Ryan, Scapens, & Theobald, 2002). As Scapens and Macintosh (1996) have noted, analysis and interpretation of this study’s findings may be differently produced by different perspectives. For this reason, the interpretations and analysis and the resulting conclusions may be speculative and may reflect the biases including that of the researcher. The study has sought to control for such biases including adopting a triangulation approach by using various sources of data including direct quotations from interviews complemented by documentary analysis and meeting observations.

REFERENCES


