

# The perceived scope of internal audit function in Libyan public enterprises

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## Abstract

**Purpose** – The aim of this exploratory study is to examine the perceptions of stakeholders regarding the scope of internal audit (IA) work in Libyan state-owned enterprises.

**Design/methodology/approach** – Data were gathered through semi-structured interviews with chief executive officers, IA directors, administrative affairs managers, financial affairs managers and external auditors, which were supplemented with a review of relevant documentary evidence.

**Findings** – The results of the study show that the scope of IA in Libyan organizations may not be sufficiently wide ranging to be considered as a value-adding service. The scope of the IA function may need to be expanded to cover a broader range of organizational functions if internal auditors are to offer value-adding services to their stakeholders.

**Practical implications** – The IA profession has received scant attention in the literature, especially in the context of developing countries such as Libya. Therefore, such settings offer the potential to enhance the understanding of IA practices. As a study on a developing economy, it enhances understanding of the IA profession's global configuration beyond the predominantly market-driven, industrialized Western economies.

**Originality/value** – In contrast to most previous studies, this study covers a broad range of IA stakeholders' views on the role of internal auditors. This coverage enabled an in-depth investigation of the factors affecting IA scope and understanding of stakeholder perceptions on the IA function.

**Keywords** Libya, Internal audit, Internal audit scope, Internal audit stakeholders

**Paper type** Research paper



## Introduction

Recent literature indicates that the role of the internal audit (IA) function has changed in response to shifts in global business practices. Such changes created opportunities for IA to provide consulting services to management and assist boards of directors to

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manage risk (Mihret *et al.*, 2010; Lenz *et al.*, 2015). Consistent with this observation, the latest definition of internal auditing issued in 2004 (Institute of Internal Auditors, 2014a) states:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

This definition signifies that IA provides services to a broad range of stakeholders, including boards of directors, top management, the auditees, external auditors and employees of the organization (Chambers, 2014, pp. 47-68). The definition indicates that internal auditors should play a relevant role in evaluating and improving the effectiveness of the risk management processes of organizations. It also presents both assurance and consulting activities as key components of the IA function. Goodwin (2004) noted that the new definition of internal auditing has shifted its focus on the IA function adding value in organizations by evaluating operations and suggesting improvements to the organization's risk management, control and governance processes. Therefore, the new definition signifies internal auditing as a value-adding function that also offers consulting services to management.

In recent decades, IA departments have become an important part of organizational structures as a value-adding service (Al-Twaijry *et al.*, 2003; Arena and Azzone, 2009; Bou-Raad, 2000; Coram *et al.*, 2008; Enyue, 1997; Goodwin, 2004; Yee *et al.*, 2008). Burnaby and Hass (2011) state that increased globalization and cross-border trade has enhanced the importance of internal auditing activities within organizations when conducting business with neighbouring countries. The importance of IA has also been confirmed in legislation such as the Sarbanes Oxley Act (SOX) (2002) in the USA, and the Corporate Law Economic Reform Program Act 2004 in Australia (Carey *et al.*, 2006). The recent spate of corporate collapses and financial scandals has resulted in an increased focus on IA as an important consideration for organizations (Arena *et al.*, 2006; Coram *et al.*, 2008; Schneider, 2003). With the global financial crisis of 2008-2009, IA becomes especially important in safeguarding the rate of return on capital and ensuring that capital is not wasted or devalued (Yee *et al.*, 2008). Soh and Martinov-Bennie (2011, p. 2) state:

In the aftermath of corporate scandals and the global financial crisis, corporate governance has received significant attention from regulators and the public. Regulatory responses have focused on increasing disclosure requirements relating to corporate governance and this has, in turn, driven increased awareness and demand for internal assurance on corporate governance processes, including internal control and risk management. Given its unique position within the organization, the internal audit function (IAF) is well placed to provide this assurance and is an integral component of the corporate governance mosaic.

However, several researchers suggest that the function may not always be effective (Al-Twaijry *et al.*, 2003; Crockett and Albin, 1995; Mihret *et al.*, 2010; Mihret and Yismaw, 2007; Montondon, 1995). This may especially be the case in developing countries such as Libya, where organizations may not recognize the value of the concepts and practices of IA as applied in Western societies (Al-Twaijry *et al.*, 2003; Mihret, 2009).

The Libyan Commercial Code 1953 requires Libyan public enterprises to have IA departments headed by directors (Government of Libya, 1953). This particular code also compels public enterprises to appoint external auditors. Moreover, since the issuance of the Law No. 11 of the year 1996 by The General People's Congress, Libyan public enterprises are required to undergo audit conducted by the Auditor General (Government of Libya, 1996). However, contrary to the West, professional standards of internal auditing are not widely applied and professional bodies of IA such as the Institute of Internal Auditors (IIA) do not exist in Libya. This has resulted in organizations establishing their own guidelines on the practice of IA (Al-Kilani, 2002; Almagory, 1998). The IA function in Western industrial societies has evolved from providing only financial-oriented compliance services to providing a broader array of value-added services. While this suggests the need to explore internal audit practices in Libya, most previous studies in Libya have focused on external audit. Hence, the goal of this study is to investigate whether IA departments of Libyan public enterprises have followed a similar evolution.

The remainder of this paper is organized as follows. The next section outlines the background and motivation for the study. Section 3 develops a research question based on a review of the relevant literature. Section 4 outlines the research method. Section 5 presents results of interviews, followed by a discussion. The final section summarizes and concludes the paper.

### Background and motivation

IA has become an integral function in helping organizations achieve their objectives and protect their assets. There is an increasing awareness of the value-added role IA can play in modern organizations (Al-Twaijry *et al.*, 2003; Arena and Azzone, 2009; Bou-Raad, 2000; Coram *et al.*, 2008; Goodwin, 2004; Institute of Internal Auditors, 2014a; Mihret *et al.*, 2010). Al-Twaijry *et al.* (2003) explain that IA departments benefit organizations by helping:

- improve organizational operations and manage risk; and
- prevent and detect mistakes or fraud, and safeguard assets.

Nonetheless, there has been relatively limited research conducted on internal auditing, especially when compared to external auditing (e.g. Al-Twaijry *et al.*, 2003; Albercht *et al.*, 1988; Arena and Azzone, 2009; Cohen and Sayag, 2010; Mihret *et al.*, 2010; Mihret and Yismaw, 2007; Mizrahi and Ness-Weisman, 2007; Yee *et al.*, 2008). As prior IA research has predominantly focused on developed countries, internal auditing remains under-researched in the context of developing countries.

In view of the limited IA research on Middle Eastern countries (Al-Twaijry *et al.*, 2003; Mihret, 2009; Mihret *et al.*, 2010; Mihret and Yismaw, 2007; Yee *et al.*, 2008), this study attempts to provide insights into IA in Libya regarding whether the scope of IA is sufficiently wide ranging to be considered value adding. By conducting research on IA in Libya, this study will enhance the understanding of IA practices in this country where the environment differs from the predominantly market-driven industrialized Western economies. The Libyan economy is not considered a market economy, and the users of accounting and auditing information are primarily the state and state agencies. Thus, in this context, a study of internal auditing enhances understanding of the profession's global configuration. A study of corporate governance mechanisms, such as IA in Libya,

is also timely because Libya cannot avoid the increasing globalization of the world economy and the adoption of the International Monetary Fund and World Bank-led economic reforms, driving the surging interest in corporate governance practices in several developing countries (Tsamenyi *et al.*, 2007).

To date, there has been relatively limited research conducted regarding IA's scope of work in enterprises operating in the manufacturing, banking and insurance sectors in Libya, where there are no national corporate governance guidelines on issues regarding IA. In the absence of widely applied professional standards of IA, Libyan organizations use their own internal guidelines on the practice of IA (Al-Kilani, 1988; Almagory, 1998; Daruish, 1990). Libyan internal auditors also have no defined or formal code of professional ethics, professional examination requirements or standards for professional qualifications for admission (Daruish, 1990). The role of internal auditors in Libya tends to be focused on fraud detection, examining accounts before payment, collecting income and checking petty cash claims (Al-Kilani, 1988).

Emerging trends in Libyan society, such as encouragement of domestic and foreign private investment, establishment of a stock exchange and adoption of international accounting standards by the banking sector and the stock market, make investigation of the role of accounting and auditing in the Libyan environment a timely research agenda (Alhsadi, 2007). As a starting point in this direction, those who follow the reality of financial accounting in the Libyan environment tended to emphasize the weakness of Libyan experience, especially in the professional field (Al-Kilani, 2002; Daruish, 1990). Also, in October 2009, the Libyan Stock Market recognized that the Arab Certified Public Accountant (ACPA) certificate offered by the Arab Society for Certified Accountants (ASCA) and the University of Cambridge International Examinations, and accredited ACPA to be equivalent to international professional certificates, namely, CPA and CA, for audit practice licensing purposes[1] (The International Arab Society of Certified Accountants, 2013).

The Libyan public sector provides a useful context for the study of internal auditing, as public enterprises dominate the economy, consistent with the policies of socialism. Thus, Libyan public enterprises are the most important source of capital formation in the Libyan economy. In other words, public enterprises currently undertake a significant amount of economic activity in Libya and are the major source of revenue for the State's budget (Mousa, 2005). Libya public enterprises are also required by law to establish IA departments (Government of Libya, 1953), and all Libyan public organizations have recently been required to undergo audit by auditors general (that is, the staff of State Audit Bureau, formerly, General People's Committee for Financial Audit) (Government of Libya, 1973). Thus, a study of IA in Libyan public enterprises would provide evidence on the national standing of internal auditing in the country, and the present paper is based on such a study in post-Gaddafi Libya.

### Literature review and development of the research question

Hass *et al.* (2006) reviewed the American IA literature and established a paradigm shift in the activities performed by internal auditors. They conclude that IA in the USA has shifted to a value-adding orientation. The study finds that the main message from the American IA literature is that the question of how IA activities create value in an organization is of critical importance. The authors highlight that before the enactment of the Sarbanes Oxley Act of 2002, IA services tended to focus on detection rather than

prevention. However, subsequent to the issuance of the Act, IA changed its emphasis to a compliance approach. Thus, through its services to the board of directors, the role of internal auditing in corporate governance has strengthened after the issuance of the SOX Act (Mihret *et al.*, 2010).

A review of European IA literature (Allegrini *et al.*, 2006) and a review of the Asia Pacific IA literature (Cooper *et al.*, 2006) generally confirms this paradigm shift. The transformation of internal auditing has been a continuing phenomenon since the 1940s when the role of internal IA focused mainly on checking transactions and records. In the 1940s, internal auditors started working on improving business processes and creating greater wealth by continuously assisting management to ensure policies and procedures were followed. Since the 1990s, IA has become a value-adding service to organizations by assisting organizations in the management of risk through using sophisticated risk modelling, statistical sampling, computer-assisted audit techniques, and focusing on total quality management as part of the audit process. Moreover, some authors suggest that the function may not always be effective (Al-Twaijry *et al.*, 2003; Crockett and Albin, 1995; Mihret *et al.*, 2010; Mihret and Yismaw, 2007; Montondon, 1995) and suggest that it is important for internal auditing to be considered as a value-added activity, as it needs to comply with International Standards for Professional Practice of Internal Auditing (ISPPIA). The scope of internal auditing work is one aspect of internal auditing that can be gauged against ISPPIA.

The scope of IA work is a significant indicator of IA effectiveness (Al-Twaijry *et al.*, 2003), and this viewpoint is supported by ISPPIA. In general, audit work should cover all systems and activities in all departments and locations throughout the organization. The International Federation of Accountants (2007, p. 9) states that while the scope of IAFs varies widely and depends on the size and structure of the entity and the requirements of management, IA activities may include the following:

- Monitoring and reviewing internal control systems, and recommending improvements thereto.
- Examination of financial and operating information. The IAF includes reviewing the means used to identify, measure, classify and report financial and operating information, and specific inquiry into individual items including detailed testing of transactions, balances and procedures.
- Review of the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.
- Review of compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

A system of internal control consists of policies and procedures designed to provide management with reasonable assurance that the business entity achieves its objectives and goals. The Committee of Sponsoring Organizations of the Treadway Commission (2013) defines internal control as:

A process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations.

The scope of IA work significantly influences the information and communication aspect of the internal control system (Fadzil *et al.*, 2005). The internal control system is an important component of enterprises, and effective internal control systems can assist in ensuring that the aims and objectives of an organization are met (Leng and Zhang, 2014). Such a system provides assurance that the organization will comply with regulations, laws, policies, plans and internal rules; and the board of directors and senior management are responsible for establishing and maintaining a strong internal control system (Badawi *et al.*, 2003).

Management should have reasonable assurance that the system of internal control is able to prevent or detect any significant inaccurate, incomplete or unauthorized transactions. The system should be able to indicate any deficiencies in safeguarding assets and deviations from laws, regulations, risk management and the organization's policies. This view is supported by Sarens and De Beelde (2006), who state that the role of management is to evaluate the risks – risk management – and establish, operate and monitor the internal control system. Internal auditors play an important role in evaluating the effectiveness of internal control systems, and contribute to ongoing effectiveness. Maijoor (2000, p. 104) states:

For financial audits, the concept of auditing internal control systems is at the heart of the financial audit explosion. As a result of the rise of internal control systems, external audits are less focussed on auditing outcomes, and more focussed on auditing systems. In addition, internal control systems are now also becoming part of the regulatory systems. Many national corporate governance reports and reforms include recommendations for internal controls, and reporting on internal controls. A joint development with the rise of internal control is the increased public significance of internal auditors.

The internal control system plays an important role in the IAF, as internal auditors are considered experts in management control (Chambers *et al.*, 1988). The scope of the auditor's activities and duties is expanding nowadays to include risk assessment, which must provide assurance regarding the effectiveness of the organization's internal controls. As auditors gain an understanding of management's strategies, business processes and controls to mitigate business risks, it will become more likely that they will use this knowledge to allow them to determine internal control strengths and weaknesses (De Smet and Mention, 2010).

The scope of IA is also expanding to determine whether the systems designed by the management are adequate and effective; and whether the activities audited comply with the appropriate requirements (Fadzil *et al.*, 2005). The IIA's Standards for ISPPA (2120 – Risk Management) state that IA must evaluate risk exposures relating to the organization's governance, operations and information systems, regarding the reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, and reviewing the systems established to ensure compliance with those policies, plans, procedures, laws, regulations and contracts which could have a significant impact on operations and reports. Implementation of these roles and activities should determine whether the organization is in compliance (Institute of Internal Auditors, 2014b).

IA also needs to carry out appraisal of existing systems and be involved in the revision or development of new systems before implementation. The IAF should assist management in the evaluation of new technology, especially in developing countries, where the auditors' support in technical areas would arguably be more paramount than

areas where the business practice remains relatively stable (Mihret and Woldeyohannis, 2008). The IIA's Standards for ISPPA (2130–Control) state that internal auditors should have an understanding of information system risks, and the IA activities must assess whether the information technology governance of the organization sustains and supports the organization's strategies and objectives (Institute of Internal Auditors, 2014b).

Thus, arguably, the IA function has undergone dramatic changes that have expanded its scope in ways that allow it to make greater contributions to organizations. It has evolved from traditional roles of "Traditional Protective Services" in terms of financial transactions to become a control which functions by examining and evaluating the adequacy and effectiveness of other controls to provide the management of an organization with information analyses and recommendations to assist it in achieving its objectives. Under this wider scope, IA assists management in areas of management of risk, operational audits and traditional financial and compliance audits (Al-Twajiry *et al.*, 2003; Albercht *et al.*, 1988). IA may be perceived as effective in both the consulting role and the traditional financial audit role (Albercht *et al.*, 1988; Al-Twajiry *et al.*, 2003; Arena *et al.*, 2006; Institute of Internal Auditors, 2014b). Furthermore, Mihret *et al.* (2010, p. 236) state:

It appears reasonable to consider that effective IA is characterized to a larger extent by a wider scope of services than a de-emphasis on financial and compliance audits.

Thus, a review of the literature shows that in Western industrial societies, the IA function has evolved from providing only financial-oriented compliance services to providing the broader array of "value added" services listed in Figure 1, which is presented in the data analysis and results section of this paper. We aim to investigate whether IA departments in Libyan public enterprises exhibit a similar pattern through the expanded scope of IA work. To this end, the main research question is as follows:

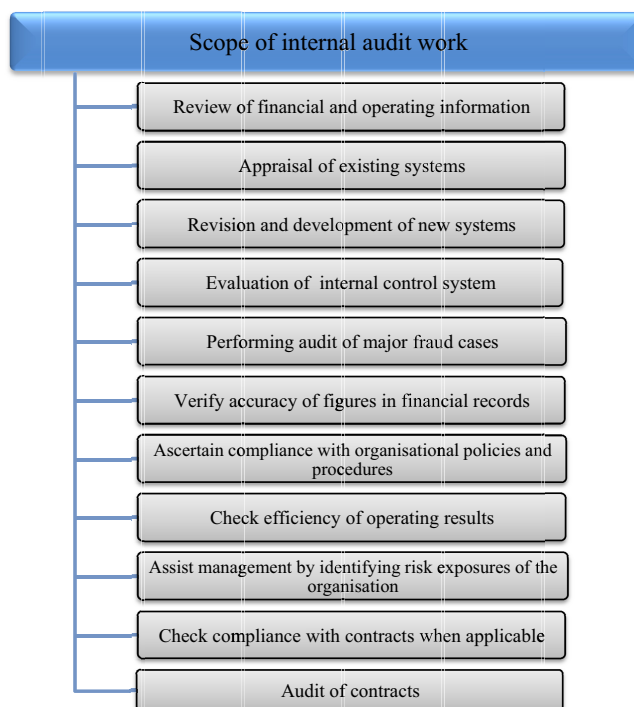
*RQ1.* To what extent does the scope of internal audit work in Libyan public enterprises extend to all systems and activities at all management levels?

### Research method

This study used a qualitative research method to enable the use of clarification, insight, discovery and interpretation of phenomena under investigation. Qualitative research helps researchers understand how people see the phenomena under investigation and examine them from different vantage points (Taylor and Bogdan, 1997) through open-ended and flexible approaches (Patton, 1990). This approach was considered appropriate for the present study because it offers the possibility of a more holistic understanding of the nature, context and processes of IA practices from the point of view of the participants (Miles and Huberman, 1994). Thus, the purpose of the study is to conduct an in-depth investigation rather than "prove" or "disprove" claims about the scope of the IA work. As Leedy and Ormrod (2005, p. 133) state:

To answer some research questions, we cannot skim across the surface. We must dig deep to get a complete understanding of the phenomenon we are studying. In qualitative research we do indeed dig deep.

A qualitative research approach also enables a study of subjects or their views in a complex real-world environment. The exploratory nature of a study of a phenomenon



**Figure 1.**  
Main elements for  
the scope of internal  
audit work

occurring in a complex real-world environment requires flexibility to accommodate emerging new insights that come to light in the course of conducting the research (Yin, 2003). Thus, qualitative research analysis, as a methodology that examines a contemporary phenomenon in its real-life context, has an important role in researching the actual functioning of IA (Chua, 1982). Adopting a qualitative research paradigm in this study allows the use of a variety of evidence within a complex behavioural context; and enhances data quality and research findings.

Semi-structured interviews were utilized to collect data, supplemented by documentary analysis. The interviews were conducted with 58 participants comprising IA directors, administrative affairs managers, financial affairs managers, chief executive officers and external auditors of 13 Libyan public (state-owned) enterprises operating in the manufacturing, commercial banking and insurance sectors. Interview participants' profiles are summarized in Table I. An inverse relationship exists between the number of participants and the depth to which the researcher can interview each one (Taylor and Bogdan, 1997). In view of this relationship, the number of interviews is considered sufficient as a source of data for the current study.

Private enterprises in Libya were not covered in the study because they are unlikely to have an IA department owing to their small size and lack of legal requirement to establish IA departments (Alhsadi, 2007). The participants were considered to be the most appropriate addressees because they are key stakeholders of IA services (Chambers, 2014). As can be seen from analysis of responses, later in the paper (Tables II and III), not all questions were presented to all stakeholder groups. Instead,



**Table I.**  
Summary of  
participants profiles

Educational qualification	Respondent category					Organization type		
	IA director	CEO	Financial affairs managers	Administrative affairs managers	External auditor	Financial institution	Manufacturing	State audit institution
College diploma	-	-	3	3	-	2	4	-
BA degree	12	4	7	8	10	12	19	10
Master's degree	1	3	2	-	2	3	3	2
PhD	-	3	-	-	-	1	2	-
Total	13	10	12	11	12	18	28	12

Items	Chief executive officers (N <sup>a</sup> = 10)		IA directors (N = 13)		Administrative affairs managers (N = 11)		Financial affairs managers (N = 12)		External auditors (N = 12)		Frequency (%)										
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No									
Review of non-financial operational areas	3	6	1	0	12	1	2	8	1	X <sup>b</sup>	X	2	8	2	7	34	5	15	74	11	
Appraisal of the existing systems	2	8	0	0	11	2	3	7	1	2	10	0	2	8	2	9	44	5	16	76	8
Involved in the audit of contract terms before a contract is signed	0	10	0	0	13	0	0	11	0	X	X	X	X	X	0	34	0	0	100	0	0

Notes: <sup>a</sup> Indicates the number of participants; <sup>b</sup> is used to indicate that the participant was not questioned in relation to this item

Table II. Summary of results regarding the scope of internal audit work

**Table III.**  
Frequency of internal  
audit involvement in  
various types of  
audit

Items	Chief executive officers (N <sup>a</sup> = 10)					IA directors (N = 13)					Administrative affairs managers (N = 11)				
	Always	Often	Sometimes	Seldom	Never	Always	Often	Sometimes	Seldom	Never	Always	Often	Sometimes	Seldom	Never
Evaluate the internal control system	7	2	1	0	0	10	2	1	0	0	X <sup>b</sup>	X	X	X	X
Perform audit of major fraud cases	7	3	0	0	0	10	2	1	0	0	X	X	X	X	X
Verify accuracy of amounts in financial records	9	1	0	0	0	13	0	0	0	0	X	X	X	X	X
Ascertain compliance with organizational policies and procedures	5	2	2	1	0	9	3	1	0	0	7	2	2	0	0
Check efficiency of operating results	0	0	2	5	3	0	0	2	7	4	0	0	1	9	1
Check compliance with contracts when applicable	0	0	1	8	1	0	0	1	10	2	0	0	2	7	2
Assist management by identifying risk exposures of the organization	0	0	2	7	1	0	0	3	8	2	0	0	1	9	1

(continued)

Items	Financial affairs managers (N = 12)					External auditors (N = 12)					Frequency (%)				
	Always	Often	Sometimes	Seldom	Never	Always	Often	Sometimes	Seldom	Never	Always	Often	Sometimes	Seldom	Never
Evaluate the internal control system	X	X	X	X	X	9	1	2	0	0	26	5	4	0	0
Perform audit of major fraud cases	9	2	1	0	0	8	3	1	0	0	34	10	3	0	0
Verify accuracy of amounts in financial records	12	0	0	0	0	11	1	0	0	0	45	2	0	0	0
Ascertain compliance with organizational policies and procedures	X	X	X	X	X	X	X	X	X	X	21	7	5	1	0
Check efficiency of operating results	X	X	X	X	X	X	X	X	X	X	0	0	5	21	8
Check compliance with contracts when applicable	X	X	X	X	X	X	X	X	X	X	0	0	4	25	5
Assist management by identifying risk exposures of the organization	X	X	X	X	X	X	X	X	X	X	0	0	6	24	4

Notes: <sup>a</sup> Indicates the number of participants; <sup>b</sup> is used to indicate that the participant was not questioned in relation to this item

Perceived scope of internal audit function

Table III.

questions relevant to each stakeholder group were selected in consideration of the respondents' relationships with IA.

Document analysis enables the review of documents from the organizations to gain extra data relating to the phenomenon being studied; and to triangulate results. Documents can provide evidence to reconcile any conflicting interpretation of phenomena by different interviewees (Brownell, 1995). According to Yin (1994), the importance of document information is one of triangulation to corroborate and add to the evidence from other sources, thereby increasing validity. For this study, the documents considered in the enterprises studied included the IA charter, records, files and letters, as well as written reports of events and administrative documents such as production reports, budgets, state decisions, progress reports and accounting statements.

Prior communication was established with the Secretariat of Industry and Central Bank of Libya, so that when selected firms were contacted, assurance could be given that official permission had been obtained regarding participation in the study. After obtaining permission from the organizations, a consent form was hand-delivered to prospective participants inviting them to participate in an interview. To enhance the validity and reliability of the interview: first, sufficient time was spent in face-to-face interaction with the participants to establish data reliability; second, one of the researchers, who also conducted all the interviews, briefed the participants on the purpose of the interview and clarified the procedures to be followed; and, third, he made appointments for the interviews at the convenience of the participants and provided participants with a copy of the questions. This clarification of purpose of the study to participants was carried out to ensure that all participants had a similar understanding about the study, thus enhancing data reliability (Fowler, 2009). Considerable support and cooperation was received from the enterprises in the form of permission for interview participation and verbal orders by the chief executive officers to the managers of departments of the organizations. This support was important in overcoming potential obstacles by management routine and bureaucracy.

The positive reaction of the participants in the study towards the questions and any interesting comments were noted and taken as an indication that the questions were meaningful and successful in as much as they provided the researcher with pertinent information. The interviews questions were pilot-tested with the first two respondents to see the interaction with interviewees and to check the timing of the interview so it could be refined as necessary. Based on the feedback of the first two interviews, additional questions were incorporated in the interview checklist; and some questions identified as ambiguous were rephrased and redesigned or, in some exceptional cases, dropped. Also, the wording of some questions had to be changed to make them more meaningful and understandable to interviewees.

### **Data analysis and results**

The IAF must evaluate the internal control system, perform audit of major fraud cases, verify accuracy of amounts in financial records, check efficiency of operating results, ascertain compliance with organizational policies and procedures, check compliance with contracts when applicable, and assist management by identifying risk exposures of the organization. This scope reflects the prevailing view of IA responsibilities in

Western industrialized economies and provides the basis to define activities that internal auditors perform. The main activities within the scope of IA work considered in this study are summarized in Figure 1.

Therefore, relevant questions related to these activities were included in the interview guide to establish whether internal auditors had expanded their scope of work to cover all areas within the organization. Traditionally, internal auditing in Western environments covers a broad spectrum of operational and financial activities (Moeller, 2005). Thus, the initial question presented to the participants relates to the scope of IA work and reads as follows:

Does the scope of internal auditing actually extend into non-financial operational areas? If yes, what aspects of audit areas are actually reviewed?

Seventy-four per cent of interviewees (34 out of 46) indicated that the scope of IA work is confined to “traditional protective services” dealing with the accounting and financial aspects of organizations such as examination of internal control systems and verifying the accuracy of financial records. The participants’ response ratios are summarized in Tables II and III. This practice occurs particularly in banks because of the financial nature of their business and banks being regarded as the absolute financial institutions. The interviews revealed that IA mostly focuses on financial audits. IA directors provided a brief description of the main aspects of the scope of IA in their organizations. They pointed out that the major IA activities in their organizations are:

- checking of daily payments and receipts for all transactions;
- checking and inspecting all salaries of the company’s employees;
- checking of all sales processes; and
- internal control of banking operations through banking settlement memorandums and tracking banking insurance letters issued to third parties.

Although IA directors used different expressions, there was an agreement that they aim to complete their accounting and financial audits first and then, as time permits, they proceed to carry out reviews of non-financial areas.

According to the participants’ responses, confining the IA work to financial areas is attributed to a number of different reasons, including the size of particular IA departments. Another reason relates to the lack of competence of internal auditors, that is, a lack of knowledge, skills and other competencies needed to perform audits in non-financial areas as most internal auditors’ possess only accounting expertise. In addition, management support to internal auditors is limited, with one IA director (Participant 4) commenting on this matter as follows:

Our work focuses on financial and accounting areas specifically, verifying accuracy of amounts in financial records to prevent the probability of significant errors or fraud. We have not focused on non-financial operational areas because I think the number of internal auditors is small compared to the large size of the organization. Also IA staff do not have enough experience to focus on non-financial matters.

This view was confirmed in interviews with external auditors. As participant 23 stated:

Internal auditors spend most of their time on the accounting and financial aspects of the operations because they have a qualification in accounting. More specifically, their

activities focus on inspection and investigation of daily payment and receipt documents to evaluate the potential for the occurrence of fraud and they work on verifying bank balances.

This is in line with [Mihret and Woldeyohannis's \(2008\)](#) study result which established that IA activities were mostly focused on financial audit. In contrast, 15 per cent of participants believe that the IA role in organizations is associated with the efficient use of resources in organizations (e.g. internal auditors providing management with useful information and recommendations for operational improvements and reductions in operating costs).

Participants were also asked to indicate whether internal auditors carry out appraisal of the existing systems and whether they are involved in the revision or development of new systems before implementation. Seventy-six per cent of participants (44 out of 58) believe that although the examination of the adequacy of existing systems and new systems before implementation is one of the most important roles of the IAF, currently the IA activities are limited to accounting and financial control systems. Also, IA has not focused on other areas such as information technology. For instance, the respondents have not been involved in determining the adequacy of security over the entire computer installation. The participants expressed the view that IA has not been involved in testing of proposed controls prior to implementation. They also indicate that IA is not responsible for the development and installation of new information technology systems or procedures but, rather, when a new system is adopted by their organization, a group of internal auditors will be trained accordingly. As one IA director (Participant 11) commented:

It is important for organizations to assess existing systems and develop new systems for the IA department, but we have not been involved in these activities. We just provide recommendation at design and operating stages of the system.

This statement is confirmed by one chief executive officer (Participant 56) who indicated:

IA is not responsible for appraising the existing systems and development and installation of new systems. This task is performed by the information technology department. In the case of using a new system for the business of the organization, a group of internal auditors will be nominated to be trained on how to use them, as well as the rest of the staff of the organization.

It appears that internal auditors have not typically examined the adequacy of existing systems and new systems before implementation. This result is consistent with the result of [Mihret and Woldeyohannis \(2008\)](#) who found that technical areas such as information technology functions of the corporation were not adequately covered by IA, which means that IA is not continuously reinventing itself to keep pace with the demands of its customers. However, the IIA's Standards for ISPPA (2130–Control) state that internal auditors should have an understanding of information systems risks and the IA activities must assess whether the information technology governance of the organization sustains and supports the organization's strategies and objectives ([Institute of Internal Auditors, 2014b](#)). The use of internal auditing is seen as an organizational tool to measure and evaluate the effectiveness of other systems ([Moeller, 2005](#)). This view is consistent with the observation by [Chambers et al. \(1988\)](#) that the

increasing volume of transactions passing through systems has encouraged today's auditor to follow a systems approach to auditing.

To determine the scope of IA work, the participants were also asked to indicate whether and how often IA performs the following activities in their organization: evaluate the internal control system; perform audit of major fraud cases; verify accuracy of amounts in financial records; ascertain compliance with organizational policies and procedures; and assist management by identifying risk exposures of the organization. Seventy-four per cent of participants (26 of 35) believe that the IA department always evaluates the control system. Monitoring of the internal control system is considered to be an important function performed by internal auditing staff. The professional literature, in terms of the auditing standards, has contributed to the role of internal auditors in monitoring and evaluating the internal control system. For example, the [Institute of Internal Auditors \(2000\)](#) issued a statement of Code of Ethics Statement No. 1, "Control-Concept and Responsibilities", which highlights that the role of internal auditors is to assist their organizations in discharging their responsibilities by providing them with information regarding internal controls. [Goodwin and Seow \(2002\)](#) argue that the existence of an IAF and strict enforcement of a proper code of conduct have a significant influence on the organization's ability to strengthen its internal controls, prevent and detect fraud and financial statement errors and enhance IA effectiveness. Similarly, [Bou-Raad and Capitano \(1999\)](#) found that internal auditors played an important role in establishing the internal control structures within the banking industry and that they are involved, to some extent, in the development stages of internal control structure.

Seventy-two per cent of participants (34 out of 47) agree with the statement that IA departments always perform audit of major fraud cases. There is no doubt that IA plays an important role in correcting situations where capital is wasted or devalued because of fraud or corruption, especially following the wave of corporate fraud during the early 2000s. In addition, 96 per cent of interviewees (45 out of 47) shared the view that the IA department always verifies the accuracy of amounts in financial records. For example, internal auditors verify that the renumbered cash receipts are prepared in triplicate by the cashier for all cash receipts, that all numbered receipts are properly accounted for and that each day's cash collections are deposited intact at the close of a day's business. However, 71 per cent of participants indicated that IA departments seldom assist management in identifying risk exposures of the organization. [Felix et al. \(2001\)](#) found that when organizations are exposed to high risk, management's demand for IA in the management of risk may be greater; and [Goodwin and Kent \(2006\)](#) conclude that the level of risk in an organization may influence IA practices. Assessing the effectiveness of risk management is also one of the basic tenets of the definition of the IAF ([Hass et al., 2006](#)) and, thus, internal auditors are generally expected to assist organizations in identifying and evaluating risks ([Walker et al., 2003](#)). Therefore, the IAF can be effective in adding value to an organization if internal auditors understand the issues of risk and assist management in improving its risk management processes ([Mihret and Woldeyohannis, 2008](#)).

While management is responsible for managing risk, internal auditors also need to understand their new role according to the new definition of the IAF. Nevertheless, the interviews show that IA departments mostly focus on financial and accounting areas. This result is similar to respondents' opinions on the last question relating to whether IA



work is confined to the traditional roles of IA in terms of accounting and financial aspects to prevent capital wastage due to inefficiencies, fraud or corruption. This result is consistent with observations of *Yee et al. (2008, p. 154)* on the role of IA in preventing waste of capital and thereby helping maintain “existing productive facilities”.

With regard to ascertaining compliance with organizational policies and procedures, 50 per cent of chief executive officers believe that IA departments always do so. However, 74 per cent of interviewees indicate that the IA departments seldom check compliance with contracts when applicable. Furthermore, there was total agreement among IA directors, chief executive officers and administrative affairs managers that internal auditors have not been involved in the auditing of agreements and contract terms established between the organizations and various internal and external parties before they are signed by the board of directors but, rather, the board of directors and chief executive officers are responsible for this function. According to the IA directors’ responses, after signing contracts, a copy is sent to the IA director for follow-up and implementation. They indicate that any contract negotiated in Libya, excluding direct supply, is subject to Revenue Duty of 2 per cent registration duty on the contract value (registration tax). This tax applies to all contracts arranged in Libya, unless they concern direct supply of goods. Such a contract must be registered with the tax authorities within a period of 60 days after signature. Should there be a delay in doing so, a fine of 3 per cent per month of the value of the tax imposed is applied until lodgement of the contract. After payment of the amount of tax due, a contract must be stamped by tax authorities as confirmation that payment of registration duty has been received (*Government of Libya, 2004*). It appears that the first priority of IA work regarding contracts is to review legal requirements such as registration of contracts with the Libyan tax authority and payment of the tax. One IA director (Participant 9) stated:

In respect of auditing of any contracts between the organization and others before adoption, the director of IA department is not allowed to do that – this matter is considered by the board of directors and senior management. Audit work in this respect is confined to accounting and financial aspects such as *reviewing payments and tax on contracts*’ (emphasis added).

Internal auditors’ involvement in the auditing of agreements and contract terms before being signed can yield several benefits to organizations. For instance, it can minimize the financial impact of potential threats posed by failure to comply with the terms of contracts, including reputational damage and safety issues. Contract audits by internal auditors, therefore, can serve as an important tool in preventing these problems (*Sangster and Venti, 2006*).

Therefore, in relation to the research question posed, the results suggest that the scope of IA is not sufficiently wide ranging. Seventy-four per cent of interviewees agree with the statement that internal auditors do not review non-financial operational areas. Seventy-six per cent agree that IA do not examine the adequacy of existing systems and new systems before implementation. However, 74 and 72 per cent of respondents indicate that IA always evaluates the IA control systems and performs audits of major fraud cases, respectively. Generally, there was almost total agreement among participants (96 per cent) that IA always verifies accuracy of amounts in financial records. Sixty-two of participants indicated that IA always ascertains compliance with organization policies and procedures. However, 71 and 62 per cent of interviewees believe that IA seldom checks efficiency of operation results and assists management by

identifying risk exposures of the organization, respectively. All chief executive officers, IA directors and administrative affairs managers agree that internal auditors have not been involved in the audit of contract terms before a contract is signed. Seventy-one per cent of participants also believe that IA seldom assists management by identifying risk exposures of the organization.

### Summary and conclusions

This study addressed the overarching research question: *To what extent does the scope of internal audit work in Libyan public enterprises extend to all systems and activities at all management levels?* Findings of the qualitative analysis demonstrate that the scope of IA work is mainly restricted to financial matters (i.e. the traditional roles of IA) such as checking accounting records, the verification of mathematical computations to ascertain that the company is not being defrauded, compliance with procedures and regulations and examination of internal control systems. In contrast, there is much less emphasis in Libya on aspects of the IA role associated with the efficiency and effectiveness of various aspects of the organization. This result confirms that IA activities are still confined to “traditional protective services”, in terms of accounting and financial aspects (i.e. a watchdog function) to ensure that capital is not wasted. This narrow scope is possibly because of the predominantly accounting background of the internal auditors. Viewing internal auditors as watchdogs is consistent with the attested function of classical IA, but is inconsistent with them being viewed as business partners. This narrow scope of IA services signifies that IA in Libyan public enterprises provides a lesser range of services to stakeholders than Chambers (2014, pp. 47-68) documented.

Although IA is a useful function in minimizing fraud and corruption (Mihret *et al.*, 2010; Yee *et al.*, 2008), in the long run, internal auditing should provide value-adding services to a broader array of stakeholders. To perform such a wider scope of work, IA departments should expand their services to cover all types of operations (financial and non-financial). In this regard, IA work should encompass checking efficiency of operating results; checking compliance with contracts when applicable; auditing of agreements and contract terms before being signed; and assisting management by identifying risk exposures of the organization. IA also needs to carry out appraisal of existing systems and be involved in the revision or development of new systems before implementation. Thus, the IA function should expand its scope in ways that would allow it to make greater contributions to the organization it serves.

Thus, the results of this study could have policy implications for the Libyan government and the management of individual organizations in terms of defining the responsibilities of IA and making relevant decisions on resource commitments to IA services to equip IA departments with the required portfolio of expertise. Moreover, the contribution of the study is not restricted to the Libyan environment as the findings could be relevant to other countries with contexts similar to Libya. The study could also be of interest to the professional associations of internal auditing in their attempts to understand the international standing of IA. Future studies exploring the relationship between IA directors and auditees' views of IA effectiveness in the actual roles characterizing IA departments is another potential research area to extend both the present study and prior IA effectiveness research (Mihret and Yismaw, 2007; Lenz *et al.*, 2014).

**Note**

1. ACPA certificate is accredited by the University of Cambridge International Examinations and is recognized by several Arab countries. The ACPA program was developed in accordance with the accredited accountant qualification curriculum issued by the United Nations Conference on Trade and Development (UNCTAD). The ACPA examinations are organized in 36 centres in different major Arab cities. Upon successful completion of the ACPA program, students attain the ACPA certificate – qualifying them to practise professional accounting and auditing, as well as granting them ASCA membership.

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