



INTERNAL AUDIT AND RISK MANAGEMENT
PRACTICES AMONG MALAYSIAN HIGHER
EDUCATION INSTITUTIONS

BY

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ABSTRACT

Governance, accountability and integrity of government service delivery are crucial factors in improving the services, operations and finances towards the stakeholders and public. The public and stakeholders are expecting good practices of integrity and it leads towards reformation in delivery of government services. Higher education institutions (HEIs), in particular public universities are striving to improve accountability and transparency in their services, operations and financial management. There are growing interests among the institutions of higher education to promote the effective governance, good financial management and accountability in public management due to various malpractices which happen currently within public HEIs. As such, the need for an effective internal audit function in HEIs is very essential to ensure the effectiveness of governance, risk and control processes. Consequently, this study aims to examine the extent of risk management practices in HEIs and role of internal audit on risk management process. The study analyses data collected from 127 staff of internal audit department from public HEIs with various grade levels. From the results, the study found that all public HEIs do have an internal audit unit which is in line with the requirement of Treasury Circular No. 2/2004. Almost more than two third of the respondents involve in evaluating the effectiveness of risk management process. Two older HEIs already have established and advanced level of risk management process. While, majority of the newer HEIs are still in level of basis and developing stage of risk management process. The findings provide insights on current practices of public HEIs in the area of risk management process and internal audit. In sum, this present study contributes the international literature pertaining to the role of internal audit on risk management in public sector. In fact, it shows that risk management process and internal audit practices in HEIs are very much driven by the changes in competitive environment and also influenced by the pressures to generate own revenue. Therefore, this would provide the awareness to the practitioners as well as the regulators that govern the public sectors to review the standard or policies of internal audit functions particularly those in public sector.

ملخص البحث

الحكومية والمسؤولية ونزاهة الحكومة في أداء الواجبات من أهم العوامل لتحسين الخدمات والعمليات الإدارية والإدارات المالية نحو أصحاب المصالح الجماهير. فإن الجماهير وأصحاب المصالح يتوقعون من الحكومة الجودة والنزاهة في أداء الواجبات، وهذا يؤدي إلى الإصلاح في تقديم الخدمات. فمؤسسات التعليم العالي، وبخاصة الجامعات الحكومية تسعى كل السعي لتحسين المسؤولية، والشفافية في خدماتها، عملياتها الإدارية، وإدارتها المالية. وقد ازداد اهتمام مؤسسات التعليم العالي لتعزيز الحوكمة الفعالة، والإدارة المالية الجيدة، والمسؤولية في الإدارة العامة بسبب تعدد الممارسات الخاطئة التي تحدث داخل عامة مؤسسات التعليم العالي حالياً. وبذلك، فإن وظيفة التدقيق الداخلي الفعالة في مؤسسات التعليم العالي في حاجة ملحة لأجل ضمان فعالية الحوكمة، وعمليات إدارة المخاطر والسيطرة عليها. وانطلاقاً من ذلك، تتجلى هذه الدراسة الهادفة إلى فحص مدى ممارسات إدارة المخاطر في مؤسسات التعليم العالي ودور التدقيق الداخلي في عملية إدارة المخاطر. فالدراسة تحلل البيانات التي تم جمعها من 127 موظف في قسم التدقيق الداخلي من عامة مؤسسات التعليم العالي وهم في مستويات الرواتب المختلفة. ومن النتائج الحاصلة، فإن الدراسة وجدت أن جميع عامة مؤسسات التعليم العالي لديها قسم خاص للتدقيق الداخلي، وهو ما يتماشى مع متطلبات المنشور الدوري لخزينة الدولة رقم 2004/2. فتقريباً أكثر من ثلثي المستطلعين شاركوا في تقييم فعالية عملية إدارة المخاطر. أما الاثنين فمن قدامى مؤسسات التعليم العالي، وكلاهما قد استعمل عملية إدارة المخاطر في مستوى متقدم. وأما معظمهم فمن أحدثهم بمؤسسات التعليم العالي، وهم ما زالوا في مستوى الأساس وفي إجراء تطوير عملية إدارة المخاطر. والنتائج تقدم الملاحظات حول الممارسات الحالية لمؤسسات التعليم العالي العام في مجال عملية إدارة المخاطر والتدقيق الداخلي. وباختصار، هذه الدراسة تتم مساهمتها في الدراسات الدولية التي تتعلق بدور التدقيق الداخلي لإدارة المخاطر في القطاع العام. وفي الواقع، تدل النتيجة على أن عملية إدارة المخاطر وممارسات التدقيق الداخلي في مؤسسات التعليم العالي تتقيد بتغيرات البيئة التنافسية، وكذلك تتأثر بالضغوط التي تطلب توليد الإيرادات الخاصة بنفسها. ولذا، تتحقق الدراسة لتوفير التوعية لدى ممارسين وكذلك منظمي القطاعات لإعادة النظر في معايير أو سياسات وظائف التدقيق الداخلي لاسيما للذين في القطاع العام.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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To my dearest parents:

Haji Wan Mustapha Wan Yaacob

&

Hajjah Yatimah Yusoff

*For giving all the love, support and encouragement throughout the duration of my
studies*

To my beloved husband:

Muhamad Rozi Suddin

*For your sacrifices, support and sharing all the sweet, pain and bitter experience
throughout the period of my studies*

To my dearest children:

Nur 'Alya Khairina Muhamad Rozi

Muhammad Ammar Fahim Muhamad Rozi

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TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page.....	iv
Declaration	v
Copyright	vi
Dedication	vii
Acknowledgements	viii
List of Tables	xi
List of Abbreviations	xii
CHAPTER ONE: INTRODUCTION	1
1.0 Introduction.....	1
1.1 Background of the Study	1
1.2 Problem Statement.....	5
1.3 Motivation for the Study.....	7
1.4 Objectives of the Study.....	9
1.5 Significance of the Study.....	9
1.6 Organization of the Study.....	10
CHAPTER TWO: LITERATURE REVIEW	12
2.0 Introduction.....	12
2.1 An Overview of Internal Audit.....	12
2.2 Risk Management	19
2.3 Risk Management in the Public Sector	21
2.4 Internal Audit and Risk Management in the Public Sector	23
2.5 Internal Audit and Risk Management in Higher Education Institutions	25
2.6 Literature Gap.....	28
2.7 Summary of the Chapter.....	28
CHAPTER THREE: THEORETICAL FRAMEWORK	30
3.0 Introduction	30
3.1 Theories in Internal Auditing	30
3.1.1 Agency Theory	30
3.1.2 Transaction Cost Economics	31
3.1.3 Institutional Theory	32
3.2 Institutional Theory and Internal Auditing in Risk Management	33
3.2.1 Coercive Isomorphism.....	33
3.2.2 Normative Isomorphism.....	34
3.2.3 Mimetic Isomorphism.....	35
3.3 Summary of the Chapter.....	36
CHAPTER FOUR: RESEARCH METHOD.....	37
4.0 Introduction	37
4.1 Research Design	37

4.2 Sampling Procedures	38
4.3 Data Collection	39
4.4 Pre-Testing	39
4.5 Questionnaire Development	40
4.6 Questionnaire Distribution	41
4.7 Overview of Questionnaire Survey	42
4.8 Data Analysis.....	45
4.8.1 Cronbach’s Alpha Test	45
4.8.2 Statistical Result Test	46
4.9 Summary of the Chapter	47
CHAPTER FIVE: RESULTS AND DISCUSSION.....	48
5.0 Introduction	48
5.1 Descriptive Analysis.....	48
5.1.1 Demographic Profile.....	48
5.1.2 Risk management	54
5.1.3 Risk Assessment.....	55
5.1.4 Risk communication.....	56
5.2 Additional Analysis	58
5.3 Discussion.....	59
5.3.1 Current practices of risk management in HEI.....	60
5.3.2 Role of internal audit in risk management practices in HEIs	62
5.4 Summary of the Chapter	65
CHAPTER SIX: CONCLUSION	67
6.0 Introduction	67
6.1 An Overview of the Study	67
6.2 Contributions of the Study.....	69
6.2.1 Contributions to Theory Development	69
6.2.2 Contributions to Practice	70
6.2.3 Contributions to Researchers.....	71
6.3 Limitations of the Study	71
6.4 Suggestions for Future Research	71
6.5 Conclusion.....	72
REFERENCES.....	74
APPENDIX A COVER LETTER AND SURVEY INSTRUMENT	79

LIST OF TABLES

Table 4.1	Response Rate	40
Table 4.2	Measurement of Questionnaire	44
Table 4.3	Cronbach's Alpha Test	46
Table 5.1	Percentage and Frequency of Respondent's Profile	50
Table 5.2	Age of Internal Audit Function	51
Table 5.3	Risk Management Process Profile of Public HEIs in Malaysia	52
Table 5.4	Level of Risk Management Process in Public HEIs in Malaysia	52
Table 5.5	Level of Risk Management Process in Accordance with The Age of The Internal Audit Unit	53
Table 5.6	Role of Internal Audit on Risk Management	54
Table 5.7	Role of Internal Audit on Risk Assessment	55
Table 5.8	Role of Internal Audit on Risk Communication	57
Table 5.9	Summary of Independent T-test Results for the Risk Management Process	59
Table 5.10	Summary of Independent T-test Results for the Risk Management Unit	59

LIST OF ABBREVIATIONS

ACCA	Association of Chartered Certified Accountants
AIA	Associates Internal Audit (Malaysia)
BOD	Board of Directors
CAE	Chief Audit Executive
CIA	Certified of Internal Auditors
CIPFA	Chartered Institute of Public Finance and Accountancy
COSO	Committee of Sponsoring Organizations
ERM	Enterprise Risk Management
HEI	Higher Education Institutions
ICT	Information Communication Technology
IIA	Institute of Internal Auditors
IPPF	International Professional Practices Framework
MIA	Malaysian Institute of Accountants
MICPA	Malaysian Institute of Certified Public Accountants
NAD	National Audit Department
NAO	National Audit Office
PTJ	Pusat Tanggungjawab/Jabatan/Pejabat/Pusat
PwC	PricewaterhouseCoopers
SOLACE	Society of Local Authority Chief Executives
SPM	Sijil Pelajaran Malaysia

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

The first chapter presents background of the study, problem statement, objectives of the study, motivation for the study and significance of the study. Finally, the chapter concludes with the section organization of the thesis.

1.1 BACKGROUND OF THE STUDY

In the era of globalization, the need for accountability and transparency is highly demanded due to the occurrence of business failures and accounting malpractices. Accountability and transparency are crucial in the public sector due to the involvement of managing public funds. Hence, the public and other stakeholders are expecting good practices of integrity, which leads towards the need for reformation in the delivery of government services. Higher education institutions, particularly public universities, are striving to improve accountability and transparency in their services, operations and financial management. There is growing interest among the institutions of higher education to promote good corporate governance, high quality financial management and resources optimization, as well as accountability in public management.

Higher education institutions (HEI) provide education programmes to the students after secondary school or A-level. According to Akta Universiti dan Kolej Universiti (1971), among the objectives of HEIs is to provide education courses, hold examinations, make provision for research, and take any other measures that appear necessary or desirable to develop and disseminate knowledge. Similar to the corporate

sector, HEIs also face a high demand for accountability. In fact, colleges and universities are struggling to improve their services, operations and finances in respect of their stakeholders as well as the public. Thus, management is accountable to provide proof to the stakeholders – the government, donors and grant providers – that their funds have been well spent according to their own agendas and priorities.

According to Malaysia's National Audit Department (NAD) reports released in 2010, 2011 and 2012, there were four audit issues involving public HEIs in 2010 and five in 2011. Moreover, in 2012, which is the latest report released, there were six cases involving public HEIs. The findings indicated an increasing trend of failures that was mostly related to poor management in construction projects that resulted in poor quality, overrun costs and projects not completed within the stipulated time, dysfunctional financial management in relation to fund management and collection, etc., as well as mismanagement of lecturer's recruitment. Hence, all of these involve risks that would give negative impact on the reputation and image of the institutions of higher education in general.

In 2010, a project was run in one of the institutions to transform the facilities that widely apply information communication technology (ICT). However, the project experienced difficulty since the contractor requested an extension on two occasions, which led to a delay in the implementation of the project. Therefore, the audit recommended that institutions perform a post implementation review for the completed module to identify the causes of failure for certain modules to ensure that similar failures would not recur again in the future (NAD Report, 2010).

Meanwhile, in 2011 there was an issue in one of the institutions concerning the management of scholarship known as the young lecturer's scheme. The audit, which was carried out between November 2011 and January 2012, found some weaknesses

in the management (NAD Report, 2011). The weaknesses included the appointment of 12 temporary lecturers who had not graduated, the appointment of 15 temporary lecturers who had exceeded the studies as stated in the terms and conditions of the agreement and 15 temporary lecturers who were appointed without proof of graduation, all of which were contrary to the procedure for the appointment of temporary lecturers.

In addition, the management of scholarship was not managed efficiently due to the irregular procedures. Some weaknesses also related to the payment of wages to a lecturer who ceased employment, as a result the institution incurred losses amounting to RM193, 066 including the claim made under the breach of contract of young lecturer's scheme. Subsequently, the institutions also incurred additional expenses for processing claims in court, since no action claim made for the breach of contract towards the scholar. All of these would create potential risks to the reputation and image of the said HEIs.

In 2012, the second biggest project in one of the newest public HEIs also faced with failure. This was considered to be a big project as it cost around RM290 million of the Ministry of Higher Education budget. The issue was raised when it dealt with some of the weaknesses in the construction project. The weaknesses included the construction work not being in accordance with the specifications, the quality of work was unsatisfactory and the job specification was not appropriate. In addition, the poor quality of materials used caused the roof structure to collapse on three occasions. The weaknesses mentioned were due to ineffective project monitoring which led to the duration of the project being extended from 176 to 445 days (NAD Report, 2012).

The preceding issues resulted in a loss of millions of dollars of public funds and resources, and an additional substantial amount of funds was needed to cover that

project. For example, in 2011 one of the public HEIs required RM1.59 million to cover the additional costs incurred for the construction project. This project was delayed due to a problem with the contractor, which led to more funds being required than the expected budget and the misuse of public money (NAD report, 2011).

Preceding issues highlighted by the NAD report underscore the importance of having risk management practices in respective HEIs. A problem or issue able to be detected earlier through proper implementation of risk management practices. However, as at 2012 only eight of statutory bodies (except HEIs) who had performed risk management practice in their organizations. Furthermore, the government has continued to take steps to strengthen governance in the public sector. Subsequently, Malaysia's Prime Minister has issued a directive regarding "Gerakan Pemantapan Keutuhan Sistem Pengurusan Pentadbiran Kerajaan Malaysia: Penubuhan Jawatankuasa Keutuhan Tadbir Urus" in November 2009. This command highlighted that all the Statutory Bodies should emphasize risk management to achieve good management performance and compliance with existing rules. This is has been emphasized even though the regulators are not required in the Treasury Circular. Therefore, the standard from others practices such as private sectors i.e.; International Professional Practices Framework (IPPF has been referred.

So, the non-existence of an effective risk management practices prevent early detection of problems and issues in major projects and other operations of the HEIs. In short, the occurrence of previous incidences as mentioned in NAD report, such as poor management in construction projects; dysfunctional financial management in relation to fund management and collection, etc., as well as mismanagement of lecturer's recruitment are mostly contributed by the absence of effective risk management practices in the HEIs to anticipate the risks inherent in the activities,

programmes or procedures. An integrated risk management can create an environment control systems to provide reasonable assurance that the statutory bodies manage to achieve an acceptable risk level. The findings from previous studies indicated the importance of risk management practices within HEIs (Arena, 2013) and the establishment of an internal audit unit as a monitoring mechanism (Zakaria et al., 2006). However, scant research that focuses on the internal audit and risk management in HEIs has been conducted. Therefore, this present study aims to fill the gap to examine the current on role of internal audit on risk management in Malaysia's HEIs.

1.2 PROBLEM STATEMENT

A series of remarkable issues declared by the National Audit Department (NAD) have been attributed to a combination of several factors including poor management in construction projects that resulted in poor quality, overrun costs and projects not completed within the stipulated time; dysfunctional financial management in relation to fund management and collection, etc.; and the mismanagement of lecturer's recruitment. Previous evidence sourced by the NAD's reports from year 2010 to 2012 showed several issues that arise in the HEIs year by year, which related to the failure of major projects and operations.

Effective risk management practice is suggested through review made by the internal audit function. At present, the scope of internal audit function activities stipulated in the Treasury Circular issued in 2004 mainly focus on the financial audit, performance audit and compliance audit. The financial audit aims to ensure the accuracy and full representation of a firm's financial records and reporting activities. While the performance audit concentrates on a firm's internal control, as well as the efficiency and effectiveness of its procedures and processes. Finally, the compliance

audit examines whether the firm is following the terms, rules and regulations prescribed by the external authority however, the latest circular did not address the need for the effective implementation of risk management practice. The Malaysia's Prime Minister has issued a directive regarding the importance of risk management practice in statutory bodies (NAD report, 2010). The establishment of the internal audit function enables the evaluation on risk management practices in order to improve and facilitate the high quality delivery financial of management services. As a result, this would fulfil and increase the stakeholders' expectations and safeguard stakeholder interest, particularly in financial management.

Those issues warrant for the existence of risk management practices in higher education institutions. Furthermore, the existence of internal audit function in public sector would evaluate the effectiveness of the governance, risk management and control processes in relation to the key business activities that are crucial for the achievement of the organizational objectives (IIA, 2009). This would assist the organization to minimize the risk exposure due to various risks surrounding the environment of the higher education institutions. Hence, an overall understanding of the organization's environment and key activities is fundamental for the purpose of identification and evaluation of significant risk exposures in the normal course of their duties (Lee, 2004). Risk management practice is crucial due to various risks surrounding the competitive environment.

Due to the importance of the internal audit in risk management, all sectors – public and private – have started to practice this process in their audit planning. Public colleges and universities are no exception in this matter. Starting in the 1990s, higher education appears to have increased and improved the efficiency as well as the effectiveness of its operations (Azad, 1994). This is due to the size, however, various

risks arise around the institutions since they are becoming larger and the management is becoming more complicated. In addition, the management of the public HEI holds the public interest as well as their trust, hence the operations should be managed accordingly and systematically to optimize the utilization of resources by mitigating the risk through the risk management process.

Previous research has been focused on the internal audit function and risk management area for both public and private entities (Zakaria et al., 2007; Ahmad et al., 2009; Badara and Saidin, 2012a; Vijayakumar and Nagaraja, 2012). However, specific studies focus on internal audit and risk management in HEIs is limited. Only few studies focused on the internal audit in HEI include Zakaria et al. (2006), Mihret and Yismaw (2007), Verdina (2011), and Musig and Kunsrison (2012). They have looked at internal audit in HEIs but not yet extensively. Hence, this present study attempt to focus on the role of internal audit on risk management in the public sector, particularly in HEIs.

1.3 MOTIVATION FOR THE STUDY

This study is primarily motivated by the issues raised in the audit reports released by the National Audit Department (NAD) for the period 2010 until 2012. In addition, this also motivated from the Prime Minister's recommendations to emphasize risk management practice in order to achieve good management performance and compliance with existing rules within statutory bodies. Among the main issues highlighted by the reports is the financial management performance of higher education institutions (HEIs). The reported weaknesses in the financial management of these institutions would have significant implications on their managerial as well as financial performance. This is due to the lack of attention to risk management

practices in the institutions by the internal auditors while the Malaysia's Prime Minister has issued a directive regarding the importance of risk management practice in statutory bodies (NAD report, 2010).

In fact, this is not an easy undertaking within the public sector including higher education institutions due to there was no specific standards and guidelines provided in any Treasury Circular with regards to risk management aspect. Whereas, for the organizations in the private sector they can refer to the standards provided by the International Professional Practices Framework (IPPF), which provides more comprehensive guidelines, especially concerning the role of internal audit on risk management, which is not available in the Treasury Circular. Hence, there is some public organizations start to copy some practices in the IPPF as their benchmark for risk management practices and start to collaborate with big audit firm to come out with their risk management framework.

Although the previous studies in this area did not cover the internal audit function in risk management in HEIs, the National Audit Department found that some issues affect the HEI's performance, for which risk management practices are needed to resolve. Thus, all of these have aspects created the interest to explore the current on role of internal audit on risk management in higher education institutions (HEIs), specifically in Malaysia. Moreover, this present study also attempts to fill the gap in the existing literature by focusing on the internal audit area of the HEIs.

The study intends to examine the current risk management practices in HEIs and the role of the internal audit function in risk management practice. The insights should enable revision of the treasury circular to reflect the current practices and move forward in terms of the internal auditor's competencies and audit methodology, as well as further improve the scope of work.

1.4 OBJECTIVES OF THE STUDY

The research objectives of this present study are as follows:

- (1) To examine the extent of risk management practices among HEIs?
- (2) To examine the extent on the role of the internal audit in evaluating risk management practices among HEIs?

In order to achieve these objectives, the following questions guided the research:

- (3) What is the extent of risk management practices in HEIs?
- (4) What is the extent of the role of the internal audit in evaluating risk management practices in HEIs?

1.5 SIGNIFICANCE OF THE STUDY

The expected insights will highlight the current practices and need for revision of the treasury circular, and will extend the current literature on the existence of risk management in the role of internal audit, especially in the area of public sector in Malaysia. Hence, the study will provide the readers with the extent of the risk management process in public HEIs in Malaysia, and the extent on the role of internal audit on evaluating the risk management process to assist the management to ensure the effectiveness and adequacy of the practices. This will support the Prime Minister's command to perform risk management practice in statutory bodies in order to achieve good management performance and compliance with existing rules.

Under practical implications, the findings may support regulators or policymakers and HEI standard setters in developing future policy; for instance, it may encourage the government to consider reviewing the Treasury Circular Guideline to be in line with the International Professional Practices Framework (IPPF) and provide more focus on the risk management issue in the public sector. This will

improve the internal auditor's current practice in terms of their competencies, audit methodology and scope of work.

1.6 ORGANIZATION OF THE STUDY

This study comprises seven chapters. The first chapter provides an overview of the background to the research. The chapter also underlines the problem statement, objectives and research questions of the study. Then, the motivation and significance of the study are also explained in this chapter. The chapter ends by presenting the organization of the thesis.

Chapter Two reviews prior literature to provide an overview of the evolution of the internal audit in the public sector. It also focuses on risk management and the internal audit in the public sector, and underlines the internal audit and risk management in higher education institutions. Finally, this chapter highlights the existing gaps in the knowledge by reviewing the extant literature.

Chapter Three provides the theoretical framework of the study, which is the institutional theory that supports the study. The proposed theoretical framework attempts to relate the role internal audit on risk management to a strong institutional structure.

Chapter Four highlights the research methodology applied in this study. This chapter provides the research design, sampling procedures, measurements used and the statistical analysis employed.

Chapter Five presents the results and discussion of the study. The results of the study are presented in table form, and, subsequently, further discussions from the findings are presented.

Finally, Chapter Six concludes the study. This chapter provides an overview of the study, including the contributions and limitations of the study. The conclusion and suggestions for future research are also addressed in this chapter.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter reviews and discusses the literature related to the present study. The first section provides an overview of internal audit. This is followed by a review of the evolution of the internal audit in the public sector. Next section discusses the concept of risk management, followed by risk management in the public sector, and internal audit and risk management in the public sector. The last section discusses the internal audit and risk management in higher education institutions. Lastly, this section is summarized by determining the gap in the present study.

2.1 AN OVERVIEW OF INTERNAL AUDIT

“Internal auditors are in position of trust” (Leung et al., 2011)

Recently, the internal audit profession has received more attention from many researchers, especially when considering its contributions to the management of either the public or private sector in respect of organizational resources (Goodwin, 2004; Zakaria et al., 2006; Ahmad et al., 2009; Asare, 2009; Vijayakumar and Nagaraja, 2012). However, as public entities have higher responsibility to their various stakeholders compared to private entities, the integrity of the internal audit function appears to be more crucial as well as significant in the public sector (Montondon and Fischer, 1999).

Due to the importance of the internal audit function in the public sector, the National Auditor General asserted that the internal audit function would assist organizations in terms of a monitoring mechanism and for observing on-going