

**PRACTICE VARIATION IN PUBLIC SECTOR INTERNAL AUDITING:
AN INSTITUTIONAL ANALYSIS**

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Abstract

This paper aims to analyse the rise of practice variations in public sector Internal Auditing (IA) giving special attention to the role of agents' embeddedness in multiple institutional arrangements. Internal Auditing's trends of development and the characteristics of the public sector context, in fact, make IA inherently subject to multiple institutional forces that interact with the system of values and beliefs of individual internal auditors.

The empirical analysis, that relies on case study methodology, highlights the inherent tensions associated with the changing role of IA and shows how different types of IA developed in three case settings, shaped by the agents' embeddedness in different institutional fields.

This paper provides a more comprehensive approach to the study of IA adoption and development in public sector organizations than previous literature, and it highlights relevance of the interplay between actors' contemporary embeddedness in professional systems and the focal social system as a relevant source of practice variation. In this respect, the case of IA can contribute to previous studies of practice variation in the field of management accounting shedding some light on the types of tensions that emerge when persons with mixed professional identities are involved in a field.

Key-words: Internal auditing, case study, practice variation, multiple embeddedness

1. Introduction

Over the last few years, research into institutional accounting has devoted increasing attention to studying the relationship between different institutional constituencies and management accounting practices; in particular it has explored how this relationship is implicated in the wider process of organizational and institutional change (e.g. Lounsbury, 2001; Modell, 2005; Modell & Wiesel, 2008; Cruz, Major, & Scapens, 2009; Englund & Gerdin, 2011; Yang & Model, 2013; Englund, Gerdin, & Abrahamson, 2013). In this context, researchers have started to incorporate the issue of organizational diversity and variations in practice into institutional analysis, focusing on how institutional and technical forces interact with and influence practices adopted by individuals and organizations in different ways (Lounsbury, 2001; Cruz *et al.*, 2009).

Initially, the emergence of practice variations was related to actors' resistance to institutionalization (Oliver, 1991), where actors experiencing conflicts and contradictions between institutional and technical pressures 'transform' imposed accounting practices. Later on, researchers embraced a more complex perspective, shifting their attention to the 'fragmented and pluralistic' nature of institutional fields (Yang & Modell, 2013, p. 104). According to this perspective, practice variations are the result of actors being contemporarily embedded in multiple institutional fields, thus needing to adopt accounting practices that accommodate multiple embeddedness (Cruz *et al.*, 2009; Englund & Gerdin, 2011). Yang and Modell (2013) developed this perspective further, proposing a multilayered view of institutional embeddedness by emphasizing that actors are not only subject to different institutional forces that are largely exogenous, but also to their individual values and beliefs, which are at least partly endogenous – an aspect which, according to the authors, has been neglected in previous research (Yang & Modell, 2013, p. 106). In accounting, institutional forces are often of a legal nature, but such regulation needs to be interpreted by actors embedded in other institutional fields. In a study of one budgetary regime, Covalleski, Dirsmith, and Weiss (2013) argued that legal

and organizational fields are mutually endogenous. These fields complement each other in intertwined and iterative processes, where the political exercise of power and resistance to this, as manifested by actors' interpretation and implementation of regulation, form the basis of practice variation.

We aim to add to this body of literature by studying the rise of practice variations in public sector internal auditing (IA), and give special attention to the role of agents' embeddedness in multiple institutional arrangements. This focus on practice variation and multiple embeddedness is particularly important in the light of the complexity and multilayered nature of the current economic context. Globalization and harmonization processes have more than ever exposed accountants and auditors to multiple institutional pressures, leading to possible conflicts and tensions between the attempt to set boundaries to the degree of variation of different accounting practices and the need for local adaptations (e.g. Guerreiro, Rodrigues, & Craig, 2014). Public sector IA provides a particularly interesting setting for the study of this topic, because development trends in IA make it inherently subject to multiple institutional forces that interact with the system of values and beliefs of individual internal auditors, and the public sector context further reinforces the heterogeneity of the institutional fields.

Thus, our study may contribute to a deeper understanding the process of change and variation in IA. In recent years, internal auditors have attempted to expand their role by widening the scope of their work to include other activities that are considered to add value to the organization (O'Regan, 2001; Arena & Azzone, 2009; de Zwaan, Steward, & Subramanian, 2011). As a result, IA's focus has changed from traditional accounting and financial control to operational control, risk management, and corporate governance (IIA, 1999; Spira & Page, 2003). This change in the 'mission' of IA has exposed internal auditors to multiple factors that may be sources of practice variation. The professional body – the Institute of Internal Auditors (IIA) – has emphasized the need to strengthen

the identity of the IA profession by developing the typical structures for professionalism (an altruistic service ideal, formal education, examination and certification of practitioners, common standards of conduct) and using the leverage of this extended IA role to redefine the contents of the profession (Arena & Jeppesen, 2010). At the same time, internal auditors have come into contact with (and are subject to the influence of) different professional communities that are active in neighbouring fields, such as external audit, risk management, and project management, which may lead to the development of divergent professional identities, as discussed in the next section.

In addition, other variables also exert influence on public sector IA, such as the overall public sector culture of the country or government where it is practised, the diversity of the organizations in which it is located, and the diversity of the auditing activity itself (e.g. Brierley, El-Nafabi, & Gwilliam, 2001; Goodwin, 2004; Van Gansberghe, 2005; Spanhove, Van Gils, Sarens, & Verhoest, 2008; Van Gils, 2011; IIA, 2009). Furthermore, IA development in the public sector is complicated by the existence of internal performance review units separate from IA (Shand & Anand, 1996; OECD, 2005), and by the influence of specific regulations in relation to accountability and internal controls that have spread worldwide in the wake of New Public Management reforms.

The practice variation perspective is beneficial for IA research, which so far has tended to focus on either agency-centred frameworks (e.g. Adams, 1994; Spraakman, 1997; Carcello, Hermanson, & Raghunandan, 2005; Speklé, van Elten, & Kruis, 2007) or structure-centred frameworks (e.g. Al-Twajjry, Brierley, & Gwilliam, 2003; Arena, Arnaboldi, & Azzone, 2006). Recognizing that both agency and structure influence IA development, we aim to contribute to IA research by bringing a new theoretical perspective to it and developing a better understanding of how and why variations emerge in IA practices in public sector organizations.

To achieve this aim, we focus on the development of IA in three Italian regions which are of particular interest for the study of practice variation. The Italian regions place the study in a

continental European context where the management of public administration is more influenced by regulation than it is in the Anglo-American or Asia-Pacific context (Selim & Yiannakas, 2000; Goodwin, 2004; Ahmad, Othman, Othman, & Jusoff, 2012; Pilcher, Gilchrist, Singh, & Singh, 2013), where most of the previous research into public sector IA has taken place. This is particularly the case in regions that manage EU structural funds and are therefore subject to EU regulations that may be at odds with recent trends in IA development (see Section 4), leaving further room for practice variations to emerge.

The rest of the paper is structured as follows: Section 2 presents the theoretical framework; Section 3 addresses the research method, with particular attention to the collection and analysis of data; Section 4 outlines the legislative context in which the research was conducted; Section 5 presents the case study according to our framework; and, finally we discuss our findings and provide conclusions in Section 6.

2. Multiple embeddedness and the rise of practice variations

Recent institutional accounting literature has highlighted how an agent's embeddedness in multiple institutional arrangements can enable existing accounting practices to be adapted and transformed (Cruz *et al.*, 2009; Kilfoyle & Richardson, 2011; Englund & Gerdin, 2011; Yang & Modell, 2013). The focus on embeddedness in these studies is not new; for instance, Granovetter (1985) discussed how actors embedded in networks of interpersonal relations seek to realize personal goals relating to social status and power. However, their perspective differs from an economic sociology perspective because it is not focused primarily on explaining the rationality of individual behaviour in the light of personal networks. Instead, the focus in these works is on explaining practice variation as an outcome of agents' interaction with the multiple institutional fields in which they are embedded.

From a practice variation perspective, agency is not necessarily related to divergent change and the break-up of institutionalized templates, as in the case of institutional entrepreneurship (Greenwood & Suddaby, 2006; Garud, Hardy, & Maguire, 2007; Battilana, Leca, & Boxenbaum, 2009). Instead, change can originate from the fragmented and heterogeneous nature of the institutional fields in which agents are embedded. This multiple embeddedness may lead to the experience of conflicting or ambiguous institutions, for instance between institutionalized professional obligations and business logics, and thus to reflexivity about the need to adapt existing accounting practices (Cruz *et al.*, 2009; Englund & Gerdin, 2011). Accordingly, there are a number of examples in recent accounting literature in which fragmented and pluralistic institutional fields have enabled agents to change management accounting practices in the search for compromises between competing institutional arrangements (Modell, 2005; Modell & Wiesel, 2008; Cruz *et al.*, 2009). For instance, Modell and Wiesel (2008) examined how performance measurement practices are embedded in different forms of public sector marketization through the analysis of two state agencies in Sweden. Based on the empirical analysis, they highlighted how, in a context of fragmented reform, actors were forced to face conflicting institutions which, at the same time, left them with room to balance tensions between different institutional arrangements. Cruz *et al.* (2009) combined the notion of multiple institutional embeddedness with that of loose coupling (Orton & Weick, 1990) in their studies of the interaction of institutional and technical forces in individual organizations. They performed a longitudinal analysis of the implementation of a global management control system in a joint venture, showing how variations in local practice were necessary for the implementation of a system to deal with different institutional forces at the local level. In this way, they pinpointed how practice variations are not necessarily derived from conflicts and tensions, but may also be shaped by the exercise of agency in cases where institutional and technical pressures coincide.

More recent works on institutional embeddedness have emphasized how the concept is multi-layered in its nature. These works envision the coexistence of multiple institutional arrangements, which can be either external or internal to the focal social system and interact with the agent's system of values and beliefs (Englund & Gerdin, 2011; Yang & Modell, 2013). In their framework for analysing embedded agency, Englund and Gerdin (2011) highlighted how agents are simultaneously embedded in heterogeneous institutional fields, both outside and inside the focal social system (for example as professionals and civil servants), and this circumstance triggers intentional as well as unintentional change. When actors are members of multiple social systems, they become aware of possible alternatives and may intentionally exploit rules and resources from external social systems in order to legitimize actions within their focal social system (Englund & Gerdin, 2011). Actors within the focal social system may also face multiple structures, system contradictions, and ambiguities regarding the definition, epistemology and causality of accounting concepts, which is likely to lead them to analyse the limitations and potentialities of established social structures and to challenge their stability (Englund & Gerdin, 2011; Kilfoyle & Richardson, 2011; Englund *et al*, 2013). Finally, according to Yang and Modell (2013), individual managers internalize their own sets of values and beliefs, which may be more or less in alignment with institutional expectations. A misalignment between these two systems may lead managers to experience value conflicts, particularly when managers embedded in multiple institutional arrangements are not able to dis-embed their actions from their values and beliefs (Kilfoyle & Richardson, 2011; Yang & Modell, 2013), and such value conflicts may lead to practice variation.

In addition to the theories of intentionally driven practice variation outlined above, Englund and Gerdin (2011) pointed out that practice variation may also be unintentional. Unintentional change is driven either by endogenous or exogenous influences. Endogenous influences emanate from within the institutional field, for instance, in the form of unintentional adaptation to ambiguous social

structures or actors adapting practices to the unintended consequences of previous actions. Exogenous influences emanate from outside the institutional field, for example, where mechanisms for diffusion result in the unintentional adaptation of practices, or where changes in the conditions for reproducing the existing social structures lead to unintentional practice variation.

This theoretical frame fits with the role of IA in public sector organizations, since internal auditors in public sector organizations often face a fragmented institutional field in relation to regulation and professional identity, and are embedded in multiple social systems that partially overlap the focal social system (i.e. the organization in which they are employed).

Previous research has highlighted how the establishment and development of IA departments are influenced by regulations dealing with internal controls, especially after the recent wave of financial scandals and corporate collapses, which have led to a revision of the regulation in many countries (Al-Twaijry *et al.*, 2003; Arena *et al.*, 2006; Van Gils, 2011). However, in many cases, regulation concerning internal controls is heterogeneous and diversified, exposing companies and managers to a fragmented reform context. For instance, some countries have specific regulation defining certain requirements that IA units must comply with, whilst other countries have regulation that is much vaguer about the existence and the role of IA departments. In the public sector, this fragmentation is further amplified by the coexistence of different performance review units established under the influence of different reform initiatives (Shand & Anand, 1996; OECD, 2005).

In addition to the influence of fragmented regulation, internal auditors are sometimes embedded in competing professional systems creating mixed professional identities (Arena & Jeppesen, 2010). The term 'professional identity' generally refers to the common sets of values, attitudes, role understandings, knowledge, and practices, which characterize members of a particular profession and set them apart from others. Recent research has pointed out that professional identity is as much a product of choice as it is a product of structures (Hotho, 2008; Warren & Parker, 2009). Internal

auditors face coexistence with different professions claiming expertise in IA work (e.g. Arena & Jeppesen, 2010) and have to relate to these claims. The Institute of Internal Auditors (IIA) is the main professional body for internal auditors; it has created the typical institutions of professionalism, such as certifications, standards, and codes of ethics to be used by internal auditors in their daily activities. However, IA is still in the process of professionalizing (Gupta, 1991; O'Regan, 2001), and thus needs to continuously adapt its role and work to create a professional identity which is differentiated from external auditing. External auditing has its own professional institutions, which in many respects are 'more consolidated' than those of IA. Hence, internal auditors' embeddedness in these different professions is a source of ambiguity, which may lead to practice variation.

A third source of practice variation in IA is a consequence of internal auditors' embeddedness in different institutional arrangements within the organization. For example, there are inherent conflicts between IA's assurance and consulting roles when the Chief Audit Executive (CAE) serves two different masters. Another example of conflicting internal embeddedness is between IA's role as value creator through operational improvement (typically achieved through operational auditing¹) and value creator through improved financial reporting (typically achieved through financial auditing). The former aligns the IA function with the company's interest in increasing organizational flexibility in order to adapt to a rapidly changing environment; the latter gives IA an interest in maintaining a tightly controlled organization in which the risk of material errors is reduced at the expense of flexibility.

Finally, internal auditors may have their own sets of values and beliefs, which can be in conflict with the values of the management of the employing organization. An example of this is provided by

¹ In this paper, we refer to generally accepted definitions of different types of internal auditing services: financial auditing refers to the evaluation of internal accounting controls, financial information, and related reports; compliance auditing refers to the evaluation of adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements; operational/performance auditing refers to the evaluation of operational processes and related internal controls aimed at ensuring the efficiency and effectiveness of business operations.

the WorldCom case, where IA played a central role in the detection of the fraudulent financial reporting (Carcello *et al.*, 2005), with the outcome that one of its internal auditors was selected Time Magazine's 'Person of the Year 2002'. Such cases may promote a distinction between IA values and management values in general, which may be a source of either intentional or unintentional practice variation.

3. Research method

In this research a case study methodology was used for the analysis of three medium–large regions located in the Central-Northern area of Italy. The 'region' is one of the four levels of Italian government (i.e. central, regional, provincial, municipal). Regions are autonomous entities with their own statutes, powers, and functions. Since the 1990s, they have been awarded responsibility for most expenditure on health, transportation, welfare, agriculture, environment, tourism, public housing and vocational training. They have also been given more autonomy in levying taxes and determining fees for services, experiencing a steady reduction in the amount transferred from the higher levels of government.

The following sections specify the criteria used for the case selection, data collection, and data analysis.

3.1. Case selection

In this study, we have chosen to focus on medium–large regions located in the Central-Northern area of Italy. The objective of the case selection was to include entities that already had an established IA function and were willing to grant access to information that is generally not available to the public. A key factor in the case selection was that publicly available information and informal contacts with regional officers had suggested that all these three entities had established some initiatives to

formalize and develop IA within their region; although they were all subject to the same regulations (as discussed in the next section), they had developed IA in different ways. Table 1 shows the main descriptive parameters of the three selected entities. Since the interviews were arranged on a confidential basis, we used three pseudonyms (*Dahlia*, *Tulip*, and *Iris*) for the organizations, and we reported approximate rather than exact figures to preserve the anonymity of the regions.

3.2. Data collection

Data were collected longitudinally between 2008 and 2011, exploiting multiple sources (Yin, 1994): semi-structured interviews, official documents and presentations, internal procedures, audit reports, and other internal documents not usually available to the public. It was also possible to attend some training sessions and presentations with regional representatives and engage in informal conversations with them. Overall, twenty-six face-to-face interviews took place involving fifteen key informants in the three regions (see Table 1 for details). Interviews were performed with the head of the IA function (or the Audit Authority), members of the IA team, divisional managers and the head of the function to which IA reported. Prior to interviews, information on the three entities was collected from public sources. All interviews were carried out on the premises of the studied organizations. Each interview lasted for an average of two hours and was digitally recorded and transcribed to support the subsequent analysis. Preliminary findings were further investigated through follow-up interviews.

[Please Insert Table 1 about here]

We addressed potential informant bias in several ways. Firstly, we interviewed highly knowledgeable informants from different organizational units. Secondly, the interviewees were informed that their opinions would be anonymized, which enabled them to speak freely in their responses. Thirdly, we asked the informants to provide factual accounts of their activities or their observations of others'

activities (e.g. meetings, participants, received reports), focusing on recent activities to limit recall bias and enhance accuracy. We always asked the interviewees for examples and explanations so we could capture the essence of their opinions and beliefs about a particular matter or situation. Fourthly, we compared data collected from multiple informants and archival sources including external reports, presentations, organisational charts, IA reports, and working papers. For instance, we tracked the changes in IA activities described by the CAE and other informants in internal documents (such as the audit manual) and in reports directed to the auditees. Similarly, we looked for evidence of scandals and problems in the news, both to corroborate the evidence emerging from the interviews and to gain a better understanding of the control environment in the three regions.

3.3. Data analysis

For the data analysis, we used within-case and cross-case analyses (Eisenhardt & Graebner, 2007). The first step was to analyse each entity. Based on the interviews and archival material we drew a timeline of the evolution of IA in each case, with particular attention to the contents of IA activities, the competencies of the internal auditors, the organizational dynamics, and the evolution of IA over the years. The contents of the transcribed interviews and the archival materials were analysed and emergent themes were highlighted relating to the two conceptual elements: sources of multiple embeddedness and IA practice variations.

Once we had completed the within-case analysis, we conducted a cross-case analysis using replication logic. We compared evidence across different cases in order to identify divergences and convergences. We searched for distinct patterns and for plausible explanations of the observed differences, trying to discriminate between contingencies and more general regularities (Eisenhardt, 1989). Then, we constructed comparative tables to identify discriminating variables that could explain similarities and differences between the analysed cases. In addition, public presentations of

preliminary findings and informal discussions with experts in the field also contributed to the refinement of the empirical analysis.

4. The context

This section provides an overview of the role of internal controls and IA in Italian public administrations, and also summarizes the specific regulatory framework for IA in the Italian regions².

4.1. Internal controls and internal auditing in Italian public administrations

Internal controls in Italian public administrations have evolved in three main stages, corresponding to three legislative decrees (LD): LD 29/1993, LD 286/1999 and LD 150/2009 (the so-called Brunetta reform). LD 29/1993 started to introduce the principle of ‘control over results’ into Italian public administrations to increase the responsibility of civil servants. It also introduced managerial instruments and tools such as the comparative analysis of costs and results, and performance appraisal and reward, and it prescribed the establishment of a unit dedicated to internal controls with responsibility for supporting the evaluation of the achievement of strategic objectives. LD 286/1999 reformed the instruments of public sector audit, ‘marking a shift from ex ante legal controls to ex post outcome controls’ (Gualmini, 2008). In doing so, it introduced a distinction between four types of control (strategic control, management accounting systems, performance appraisal and reward systems, administrative and financial controls), which became compulsory for all public sector organizations in Italy. Finally, the Brunetta reform of 2009 covered four specific areas: individual and organizational evaluation, performance-related pay and bonuses, new collective agreements with trade unions, and the simplification of disciplinary procedures. In particular, it introduced a

² For an analysis of new public management (NPM) trends in the Italian context see also Panozzo (2000).

performance measurement system for all public administrations, central to which was individual performance evaluation, a key driver in improving public sector efficiency.

IA was not explicitly formalized by this legislative framework, although the regulations specify several control activities that fall within the remit of the IA service; these include financial and compliance auditing, and operational and performance auditing. However, the lack of formal recognition of the role of IA within public sector organizations has resulted in a form of ‘definitional ambiguity’ (Englund *et al.*, 2013) – thus the public sector entities do not have a clear definition of IA. The IIA has attempted to promote the potential role of IA in relation to internal controls, as shown by the following extract from a recent position paper by the Italian Chapter of the IIA:

‘To protect the public interest, any public administration requires an independent audit that provides a range of assurance and consulting services, such as financial certification and operational functional efficiency, whether it takes place through the use of internal or external auditing services, or through the combined use of the two. The mandate of the audit function in the public sector should be as wide as possible to enable it to address all the purposes of governance activities’. (AIIA, 2008)

In addition, the IIA has also developed training courses and seminars specifically targeted at public administration officers. However, compared to the private sector, the ability of the professional body to act as a reference point for actors dealing with internal controls is rather limited. Not only is the participation of internal auditors in the activities of the IIA totally voluntary, but there are also different bodies and associations dealing with the issue of internal controls in public administrations (beside the IIA), leading to a high degree of fragmentation. Among these are committees/authorities that are specifically responsible for developing transparency and control in public administration, particularly the *Servizio Anticorruzione e Trasparenza* (SAET), which was founded in 2008 but replaced by the *Commissione Indipendente per la Valutazione, la Trasparenza e l'Integrità delle*

Amministrazioni Pubbliche (CIVIT) in 2010³. There are also ‘consulting’ bodies, in particular Formez, a national body that aims to support public administrations, and specifically regional and local entities, in the development and monitoring of administrative and organizational innovation projects. Finally, there are other professional associations, in particular the chartered accountants’ professional body and the *Associazione Nazionale Direttori Amministrativi e Finanziari* (ANDAF), whose members include professionals that are responsible for administrative, financial, and management control functions.

4.2. Internal auditing in Italian regions

The original *raison d'être* of IA in the regional entities relates to the need to perform second level control of European structural funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF), and the Cohesion Fund.

In this context, there are major legislative references to IA in European Council regulations, which provide specific guidelines about the management and control of activities that are co-financed through these funds (EC Reg. 1083/2006; EC Reg. 1080/2006; EC Reg. 1081/2006; EC Reg. 1082/2006; EC Reg. 1084/2006). In particular, EC Reg. 1083/2006 lays out the general principles of management and control that an entity must comply with to ensure the sound financial management of its operational programmes (OP)⁴. For each OP, three authorities must be appointed: (1) the managing authority, in charge of managing the OP; (2) the certification authority, responsible of certifying expenditure declarations before sending them to the EU Commission; and (3) the audit authority, responsible for verifying the effective functioning of the management and control system.

³ In 2013, CIVIT was replaced again by *Autorità Nazionale AntiCorruzione e per la valutazione e la trasparenza delle amministrazioni pubbliche* (ANAC).

⁴ The Operational Programme is a document approved by the Commission, in which the entity defines the objectives, the sets of priorities, and the multi-year activities to be performed. It is the reference document for implementation of co-funded projects.

Under the 2000–2006 programme there was no explicit requirement to have an audit authority, only for an activity of undertaking spot-checks on operations (EC Reg. 438/2001, Art. 10) that had to be assigned to an independent body. Replacing this, the 2007–2013 programme has introduced the audit authority as an integral part of the management and control system (EC Reg. 1083/2006). The authority is responsible for:

- ensuring that audits are carried out to verify the effective functioning of the OP management and control system;
- ensuring that operations are audited on the basis of an appropriate sample to verify declared expenditure;
- presenting to the Commission, within nine months of the approval of the OP, an audit strategy covering the bodies that will perform the audits, the method to be used, and the indicative plan for the audits.

Table 2 summarizes the expected roles of IA in different institutional arrangements.

[Please Insert Table 2 about here]

5. Case settings

This section presents the results of the empirical investigation. The three cases studied show how CAE embeddedness in multiple institutional arrangements is implicated in the evolution of IA, leading to different organizational configurations despite the regions' common starting point (i.e. with no IA activities in place).

5.1. Dahlia

IA was introduced in *Dahlia* in 2003, when a staff function named *Audit dei Fondi Strutturali* (Structural Funds Audit) was established in accordance with EU regulation with the aim of performing second level control of EU funds. Responsibility for this unit was assigned to a manager, already employed in *Dahlia*, with the title of *Responsabile Audit* (Chief Audit Executive). The CAE held a Master of Economics degree and had significant experience within the region. Before 2003, he had been in charge of another function dedicated to investment policies and project financing, and he had prior experience of the accounting department, although not of the audit field.

In this initial phase, the CAE became embedded in the EU institutional field, getting acquainted with the regulation concerning the auditing of EU funds. He and his staff (four persons) started this new activity ‘without a clear pathway set out’ (member of the IA team) and audit activities were initially configured on the basis of the requirements of EU regulation in terms of both the scope of IA and the methodologies adopted. In particular, the IA scope focused on the auditing of EU funds, and auditing activities were carried out on the basis of the methodologies required by the EU Commission, which, however, asked for an increasingly high level of formalization, gradually raising the bar for IA.

‘The regulation required us to use certain methodologies. From this point of view, the progress has been steady and fast. Initially the Commission said: “Check a sample of transactions”, but soon we started to talk about System Audit; then we were required to do an audit of the procedures adopted to manage community funds, and then the expectations of the audit service were raised even more’. (CAE at *Dahlia*)

This situation influenced the development of IA, which, over the years, evolved significantly in terms of its working methods and the tasks it performed in order to ‘keep up with the development of EU norms’.

Early on, the CAE's embeddedness in the EU system started to interact with his embeddedness in his focal social system, the region. At the regional level, officers were facing increasing demands for efficiency and transparency. These were determined by the different regulations on internal controls, the establishment of a central body responsible for fostering transparency among public administrations (SAET and later CIVIT, as described above), and, in particular, by the calls for reform of public administrations coming from public opinion. As the CAE put it:

'Over the last years, we [the region] have been under scrutiny for how we use resources, how we employ the money of the citizens. We cannot waste money, and we have to demonstrate that we do not waste it'. (CAE at *Dahlia*)

This call for transparency was echoed by other interviewees that highlighted how 'these days public administrations need to prove efficiency and accountability' (Head of Management Authority). At the same time, the CAE also seemed to feel a personal commitment to answer these calls, as is apparent from the following:

'It [Improving efficiency] does not only deal with doing our job well, it is something more. It is a moral commitment. [...] We are civil servants and our activities should be aimed at serving the community. If there is a way of improving things, we should go for it'. (CAE at *Dahlia*).

Hence, his experience with the auditing of EU funds made him aware of the possibility of broadening the scope of IA in the region, because he saw its potential for addressing a problem that was considered relevant within his focal social system (i.e. the region) and doing something that would be 'useful' for the region and the community. Furthermore, the possibility of addressing these issues was consistent with the values of the reform agenda that he seems to have internalized in previous positions in the region (Yang & Modell, 2013) in which proactive agency was an integral part of his role. Thus, as CAE he was now willing to do 'something more' and to 'find a solution' to problems

(CAE). These circumstances made him look for a way of going beyond the normative requirements and applying the concepts and instruments introduced in relation to EU funds to other regional activities. In this way, the CAE ‘pulled in’ an institutional practice from another social system (Englund & Gerdin, 2011), the EU.

Consequently, he presented IA to the Cabinet Secretary as a means of increasing transparency and addressing the frequent calls for higher accountability from central government and public opinion. He put forward IA as a solution to potential problems in the region, and he found a ‘favourable context’, since there was no opposition to proceeding in this direction. He also tried to communicate this new perspective by altering the name of the function in 2005 from ‘Structural Funds Audit’ to *Audit interno* (‘Internal Audit’).

[...] We implemented IA to fulfil an obligation; then, we recognized that these methods could also serve to control activities which were not related to EU funds. [...]. The name we use, our name tells this story. Our function has been called “Internal Audit” since 2005. We started as “Structural Funds Audit”; then, we changed our name into “Internal Audit” in order to communicate this idea. We wanted to move from an approach where “the Commission says that we have to do internal auditing and so we do it”, simply fulfilling a mandatory requirement, to a different approach based on the idea of adhesion, of the use of a certain methodology because we think it is useful’. (CAE at *Dahlia*)

With the introduction of the EU 2007–2013 funding programme, a few audit procedures related to other processes than structural funds were introduced. To reflect this change, the IA function was re-structured into three areas: (1) *Audit dei Servizi alle Persone* (‘Audit of Services to People’), dealing with audits of the OP funded through the ESF; (2) *Audit delle Azioni di valorizzazione del territorio e servizi alle imprese*, (‘Territorial development and services to enterprises audit’), dealing with audits of the OP funded through the European Regional Development Fund (ERDF); and (3) *Coordinamento, Pianificazione e Reporting Audit Interno* (‘Planning, coordination and reporting’), which included all

activities concerning IA planning and coordination as well as auditing activities and other initiatives not directly related to EU funds. In addition, the number of internal auditors grew from four to fourteen people.

In this phase, the balance between the audits of EU funds and audits of other regional activities was still towards the former. Furthermore, audits of regional activities were initially focused on financial and compliance issues, as these audits aimed to ensure the reliability of financial information and compliance with regulations and internal procedures (e.g. the call for tenders, competitive bids, contracts). However, the extension of IA to regional activities proved to be a significant step, since the CAE was able to extend IA responsibilities to a field that was not originally included in IA's scope. This extension required the CAE to modify its working practices, hence creating some 'local adaptations' (Cruz *et al.*, 2009). IA procedures were subject to hybridization in connection with both the planning and execution of audit activities. While the planning of audits of EU funds was performed through a yearly audit plan, which was part of a long-term strategy formulated according to EU requirements, the internal processes to be audited were chosen by the CAE and the Cabinet Secretary, based on their insights and knowledge. The 'final audit plan' was a hybrid of the two documents. To support the execution of the field work, new checklists and interview guides were also created that applied to regional activities. In general, they were simplified versions of the checklist used for EU funds audit. Furthermore, the first meetings with the auditees had an 'educational' function and were focused on explaining the aims and the objectives of IA in general, whilst previously these meetings had focused on the specific objectives of the audit. The prominent role played by the CAE in fostering this change was openly recognized by his colleagues, who looked to him as the 'father' of IA in *Dahlia* (Divisional manager at *Dahlia*).

The CAE's embeddedness in the EU system continued to play an important role in driving the development of IA and the introduction of new methodologies. In 2008, the IA function coordinated

a Control Risk Self-Assessment (CRSA) project, which aimed to develop the auditing strategy for the 2007–2013 audit programme. Regional officers were required to evaluate risks impinging on their areas of responsibility, and their findings were discussed in four workshops organized by the IA function. The EU Commission’s requirement that the audit strategy should be defined gave the CAE an opportunity to introduce the control risk self-assessment (CRSA) technique and to involve the regional management, which would not otherwise have collaborated on this.

‘The requirement of the EU Commission was an opportunity from my point of view. The requirement gave me justification to do this [CRSA], which I couldn’t have done otherwise. Another thing is going to the directors without any requirement of my own. I think I’ll be able to get there in the future, but I need some time. We are not ready yet’. (CAE at *Dahlia*)

In doing this, the CAE leveraged his embeddedness in the EU system and the existence of related EU requirements to legitimate his broader concept of IA by pinpointing the potential benefits associated with similar processes.

At the same time, the CAE started to become embedded in a different and potentially competing institutional field, the IIA. He attended workshops, conferences, and training programmes in IA that were not focused solely on the public sector. This was a relevant source of ‘cross-fertilization’ (CAE), because it allowed the CAE to understand the nature of IA in different contexts, including which tools to use and how these tools might contribute to making IA more effective and efficient. Through his participation in the activities of the IIA and other academic and practitioner events, the CAE accessed information that influenced his view of IA and the actions he took to change the IA role.

The CAE’s embeddedness in the professional body resulted in the emergence of further variations in IA practices in *Dahlia*. IA activities were still performed according to guidelines provided by the EU Commission, but some additional elements were integrated into it. The planning of audits of regional activities started to be based on an internal risk assessment, which was more

formalized than in the past. A number of references to the IIA standards were included in the audit manual in relation to both management of the audit and preparation of the audit report. Internal auditors were required to perform the audit in accordance with IIA standards (in addition to the EU guidelines). These changes were widely promoted within the IA unit, encouraging internal auditors to participate in training initiatives organized by the IIA and in seminars arranged in conjunction with the IIA and local universities. As stated by a member of the audit team, the CAE ‘devoted much effort, in terms of time and resources, to making this change happen’ (Head of Audit Authority).

News of the IA change in *Dahlia* started to spread beyond the region. The CAE was invited to speak at conferences organized by the IIA, universities, and other public institutions. He also authored practitioners’ papers on how IA’s role could be transformed in the public sector and how this could contribute to ensuring efficiency and accountability. Within the community of internal auditors he was recognized as one of the key experts in the field of public sector IA, being defined a ‘leading voice’ in the field (member of the IIA Italy).

However, the CAE’s simultaneous embeddedness in the regional system, the EU system and the professional body also led to the emergence of tensions at two levels: between IA’s focus on financial and operational auditing, and between IA’s assurance and consulting roles. He felt that auditing methodologies might have the potential to improve the operational processes of the regional administration in a way that went beyond the traditional IA roles of preventing line managers’ opportunistic behaviour and verifying compliance with internal and external regulations.

‘First we moved from auditing structural funds to auditing regional activities; then, we started to perform “intelligent audits”. We moved from compliance audit to operational audit. [...] The original approach with EU funds, was, is, financial audit. When auditing EU funds, we have to check that regulations are adhered to. [...] Compliance as regards funds and also operations is certainly important, but we also work in the direction of introducing operational audits, or, at least, we are trying to. [...] In this field [i.e. operational auditing], we are trying

to move from pure assurance to consulting services. Here, we can have a word about how to improve the regional processes'. (CAE at *Dahlia*)

Consistent with this shift, in 2008 the CAE issued an official outline of internal auditor competencies, which defined the internal auditor as having a 'high-level role responsible for designing, evaluating, and monitoring the entity's governance system'; that is, the internal auditor should be knowledgeable in relation to risk management, business process analysis, internal controls, and auditing (official document). The CAE paid particular attention to the development of the professional profile of the internal auditors, and he attempted to communicate his ideas of IA to the other members of the organisation:

'[...] We have to put a marketing process in place. If we present ourselves as the "carriers of the creed of regularity", we would be seen as partial people, who only understand the procedures'. (CAE at *Dahlia*)

This change was also recognized by other officers within the region, who noted that IA had changed over the years by 'focusing on different aspects and addressing more managerial problems' (Integrated Planning Officer).

All these actions resulted in a major organisational change that was implemented in 2010, when the IA function was divided into two different departments reporting to different organizational units: *Audit interno* (Internal Audit) and *Audit dei Fondi Strutturali* (Structural Funds Audit). This change was determined by the recognition of the differences characterizing IA performed on regional activities and Structural Funds audits. The internal audit function remained under the guidance of the CAE, still reporting to the *Segreteria di Gabinetto* (Cabinet Secretary), while the Structural Funds Audit was placed in the *Programmazione Integrata* (Integrated Planning) function reporting to the head of department. The CAE was given responsibility for fully implementing IA in regional activities. Resources were allocated to him in the form of eleven members of staff, and he was given

decision-making powers since he was in charge of shaping the IA processes and introducing approaches and methods that were better suited to the new situation. From this perspective, the CAE started to prepare a new IA manual focused on auditing regional activities. Once again, it was necessary to vary IA practices to adapt to the changed conditions. The IA plan was prepared on the basis of the regional programme objective in order to establish a clear link between auditing activities and their contribution to the achievement of the entity's objectives.

'We are trying to make a change whereby the object of the audits is no longer the offices, the procedures, the laws, but the regional programme, with its hierarchy of objectives'. (CAE at *Dahlia*)

However, the CAE was uneasy about the decision to divide the audit department into two different functions. He was still strongly embedded in the EU system, and the link to structural funds had been both a threat and an opportunity for IA (the CRSA project provides a significant example of this relationship). Moreover, the mandatory nature of the structural funds audit had given legitimacy to auditing activities, and its relocation to another department could affect the legitimacy of the IA in the eyes of other regional officers.

5.2. *Tulip*

IA was introduced in *Tulip* in 2002, when the *Controllo di Gestione* (Management and Control Unit – MCU) was given responsibility for the second level controls of the 2000–2006 OP. The MCU reported to the Vice-President of the Cabinet, and was primarily responsible for monitoring the efficient and effective use of financial resources. The inclusion of IA among its responsibilities was determined by the need to comply with European Commission requirements.

‘Internal Audit has been introduced in the region because the EU started to require us to apply audit techniques to EU funds. The birth of the idea of internal audit, its origin, was there’.

(Head of Finance at *Tulip*)

The main reason this responsibility was assigned to the MCU was because of the competence profile of the head of the function (*Responsabile Controllo di Gestione*): a chartered accountant, with prior experience as CFO in the private sector and with a strong background in the finance area. He was already familiar with auditing concepts and techniques and was a member of the chartered accountants’ professional body and of the ANDAF. In addition, because he was in charge of the MCU he was familiar with other control activities required by the regulation on internal controls (i.e. management accounting). In other words, he was already embedded in both the regional system and the accountancy profession, which was seen by other regional officers as a qualifying criterion for taking on the responsibility of auditing EU funds. According to the Head of Finance, he had the ‘right competencies’ to deal with the requirements of EU regulation ‘without need to turn things upside-down’ (Head of Finance).

At the beginning, IA was carried out ‘on the sly’ (Head of the MCU). Auditing activities were mainly performed by an external auditing company, and it was up to the MCU staff to coordinate and verify the work carried out by the external auditors. The regional staff only joined the external auditors during field interventions on a few occasions. The level of formalization of the internal procedures in relation to IA was relatively limited. The head of the MCU made an attempt to standardize working practices and prepared a ‘small audit manual’ (Head of the MCU) to describe the procedures to be applied to control and validate the work performed by external auditors. Obviously, he was familiar with the requirements of EU regulation, but there was no evidence that he had any intention to become too engaged with the related activities. He was strongly reliant on the

external auditing company and did not change the organizational structure or the division of tasks in the MCU. As the Head of the MCU put it:

‘There was no need to change our structure and our routines; we were able to manage the auditing of EU funds, thanks to external consultants. We simply had to verify that the requirements of the regulation were complied with’. (Head of the MCU)

With the start of the 2007–2013 Funding Programme, which explicitly required the establishment of an *Autorità di Audit* (Audit Authority), the head of the MCU and his staff gradually became more embedded in the EU system. The regulatory requirements grew and demanded stronger involvement of the regional staff in the audit activities. The regional staff, in turn, became more acquainted with the EU system and attached, at least formally, greater importance to the auditing of EU funds, and also became more competent in this field. Evidence of this was provided by the official inclusion of the auditing of EU funds in the list of the tasks performed by the function and the introduction of a greater degree of formalization of IA practices by the head of the MCU. Although auditing activities were still performed by an external auditing company, he decided that one MCU staff member should always join external auditors in their fieldwork. A team of four people was formed and officially given the responsibility for coordinating IA tasks. They were not fully dedicated to IA, but continued to perform other management accounting activities such as investment analysis and evaluation of financial performance. Since none of them had specific competencies in IA, they attended training courses on how to handle EU funds, which led to a progressively greater embeddedness in the EU system and greater influence of EU regulation on the development of IA practices. Over the years, the internal resources dedicated to IA increased, reaching six people in 2008. However, the members of the IA team continued to be dedicated partly to IA activities and partly to management accounting activities.

‘Originally, audits used to be performed by the consultants. My role was mainly to keep in contact with them, sometimes to supervise their work, but I rarely participated in the audits. Later on, this changed. We had to participate in the audits and perform the intervention in conjunction with the consultants. They were the ‘specialists’, but we had to coordinate their work, participate in the audits, check their reports. We started to play a more active role. At the beginning it was not like that’. (Member of the MCU staff)

At this stage, the head of the MCU followed the legislative requirements precisely, without making any attempt to extend IA concepts and ideas to other activities in the region. When required by regulation, he introduced new auditing tools and instruments; however, he always limited their scope to structural funds. The development of a risk assessment project in 2008 is a relevant example of his approach. EU regulations required the region to perform a risk assessment to define the auditing strategy for the 2007–2013 Funding Programme. Following this requirement, the audit team performed a risk analysis, which was indeed totally focused on financial risk management, with specific attention to the ‘risk of finding an error in the reviewed records’. The influence of the regulation also emerges in the document accompanying the presentation of the project.

‘The region, in accordance with Community and national provisions, has established a control system based on the application of risk analysis to define the sample of transactions to be tested in situ [...]. The risk assessment is aimed at identifying the likelihood of error during the control action’. (Official presentation)

All of the interviewees appeared sceptical about the possibility of extending this approach beyond pure financial risk or applying it to other regional activities. Regional officers did not see the usefulness of extending the approach to other areas, since there was ‘no requirement to do that’ (Divisional Manager). The head of the MCU argued that an extension of the risk analysis would have required the development of an analytical methodology, which would have been ‘too complex’. He considered IA could be potentially helpful in the monitoring of regional activities, but he argued that

such concepts and ideas would hardly fit with *Tulip*'s style of thinking. In this sense, he was aware of the existence of potential alternative roles for IA but considered that these were at odds with the situation prevailing in the region; therefore, he did not engage in practice variation:

'In the region, managers and officers do not have an economics background. Most of our managers are architects, they have various master's degrees in the humanities, and there are also some engineers. But there are only few people with an economics background, even fewer with an auditing background. In the best case, managers have achieved a master's in political science, and a specialization in economics, but that's all. Auditing was born in the business world. Risk management was born in the business world. They are not considered relevant here. The region is not ready for this'. (Head of MCU at *Tulip*)

In addition, the fact that he was in charge of other internal control activities (management accounting) may also have limited his propensity to change IA. He appeared to be keen on 'protecting' the management accounting domain – in which he was clearly embedded – from the creation of overlapping areas of responsibility by extending IA's role. One manifestation of this was that he presented himself as 'the *Head of the MCU* to whom responsibility for audit authority was assigned' [emphasis added] (Head of the MCU). During the interviews, he contrasted the broad role of management control with the clearly defined scope of IA in 'auditing EU funds' (Head of MCU). He presented management control as a strategic activity for the region, whose remit spanned control of efficiency, cost-effectiveness, and evaluation of strategic plans. Although his interest in efficiency and effectiveness could easily have been incorporated into IA's work by assuming an operational auditing role, he presented IA as a narrower activity specifically aimed at compliance with EU regulation. A possible explanation of this is that he seemed to associate the source of his power with his role as head of the MCU, from which he derived allocative and authoritative resources, as he suggested in the following examples: 'I'm the head of the management and control unit', 'management control is a strategic activity for the region', 'management control provides information

that is relevant to making decisions’, and ‘IA is needed to comply with EU rules’. Accordingly, he showed no intention to change the power balance between management accounting and IA.

In other words, there was a (temporary) alignment between the ‘core values’ that characterized different institutional arrangements in which the head of the MCU was embedded and his personal interests. The region, the EU system, and the chartered accounting profession shared a view of IA that was mainly focused on compliance and assurance, which was consistent with the traditional monitoring role of IA (Morgan, 1979). Consequently, the head of the MCU did not feel the influence of other institutional arrangements (e.g. the IIA) because he did not participate in them. As a result, no variation in IA practice emerged at this stage and the head of the MCU did not appear to have any interest in proactively promoting a different role for IA internally, as clearly emerges in the following extract from the interview:

‘Interviewer: Who is promoting IA internally?’

Head of the MCU: At present, me.

Interviewer: Have you discussed the possibility of changing the role of IA with anybody?’

Head of the MCU: I had a chat with some of the people I work with. Sometimes we discuss the possibility of doing internal auditing in a different way, of extending auditing activities to other regional activities’. (Head of MCU at *Tulip*)

This situation started to change in 2009, when there was a scandal concerning the allocation of financial contributions to support cultural associations. One of *Tulip*’s major beneficiaries was involved in allegedly illegal procedures. Although the event was not noticed at national level, it was a big story in the region, and mobilized local newspapers and citizens’ associations in protest. Hence, the event served as an external shock to the focal social system, which resulted in a renewed focus on controls and transparency in the region.

‘The news made a big deal of it. We had been in the newspapers for several days. The region was not directly involved, but since it was one of our major beneficiaries, we were pulled in.

We had to do something to show that we do things properly and that money is allocated following certain rules and we control how it is spent'. (Head of MCU at *Tulip*)

The scandal made the head of the MCU and the leaders in the region reflect on the role of IA and the unintended consequences (Englund & Gerdin, 2011) of limiting its role to EU funds. In the beginning, this choice had appeared consistent with the *status quo*, because there were no differences between different institutional arrangements, namely, the EU system, the regional system, and the chartered accounting profession. However, the scandal proved that there were tensions between the limited role of IA in auditing structural funds and its potential role in preventing and detecting fraud in other regional activities. This led to the emergence of a variation in IA practice in the form of a task force consisting of IA team members and a few staff of the *Segreteria di Gabinetto* (Cabinet Secretary) which was established with the aim of rethinking the governance mechanism relating to the assignment of financial contributions to cultural events. In this respect, IA served as a possible solution to a new problem: the need to ensure transparency and accountability.

However, the embeddedness of the head of the MCU in the above institutional arrangements, in conjunction with his own interests (Yang & Modell, 2013) and the existence of a certain definitional ambiguity about IA (Englund *et al.*, 2013), significantly affected the (limited) development of IA. In fact, the task force never became a permanent organizational structure, but it was activated at the request of the Cabinet Secretary. This kind of IA provided a sort of 'audit on demand' carried out on an ad hoc basis when a specific problem was identified in an organizational function. Between 2009 and 2011 the task force performed a few internal audits of processes, including those related to cultural contributions, tourism contributions, sporting events, and some companies partially controlled by the regional authority. These audits were all focused on financial and fraud issues: they aimed to ascertain the reliability of financial documentation and the effectiveness of the control mechanisms put in place to avoid the misappropriation of funds. There was no evidence that the head

of the MCU played an active role in fostering the diffusion of IA in the region on a more official basis, and he did not do anything specific to exploit this activity by extending the role of IA to consulting services, which indicates that the IA role was consistent with his interests and the existing structure. Also, when speaking about the future of IA, the head of MCU justified the possible introduction of a separate IA function by the increase in resources dedicated to IA (from four to nine part-time staff in 2011) rather than by a shift in the potential role of IA in the region.

‘We are thinking of establishing a real IA function maybe this year, maybe next year. This function will be responsible for auditing EU funds and also for carrying out these other initiatives [audits on demand]. We expect that it will be up to 80% occupied with auditing EU funds and 20% with doing internal reviews’. (Head of the MCU at *Tulip*)

Again, the lack of commitment demonstrated by the head of the MCU could be explained by the institutional arrangements in which he was embedded and the existence of some ‘definitional ambiguity’ (Englund *et al.*, 2013) about what IA should be, thus allowing him to shape the IA in a way that was consistent with his own interests and the existing structure. He was well-informed due to his background as a chartered accountant, which led him to regard IA mainly as financial auditing. As mentioned above, he referred to the profession of chartered accountants and external auditing companies when he was identifying the potential development paths of IA and attached almost no importance to the position statements of the IIA. Consequently, he conceived the role of IA as being more related to transparency and the reliability of financial statements than operational efficiency and effectiveness:

‘Having an internal audit function is a signal of transparency, because it means that there is a body that does control systematically and programmatically, and ascertains that laws, regulations, and procedures are respected’. (Head of the MCU in *Tulip*)

5.3. *Iris*

The IA unit in *Iris* was established in 2008. Before this, the auditing of EU funds was externalized. At the beginning of the 2000–2006 OP, second level controls were assigned to the Finance Unit, which outsourced these tasks to an external auditing company. According to the interviewees, the Cabinet and the Finance Department decided not to invest in developing in-house competencies in the auditing of funds because it was not considered to be a core activity of the Finance Department. In addition, EU funds were perceived as being subject to high uncertainty, as in the following excerpt:

‘Today, there are structural funds, but tomorrow, who knows? Now we know that the EU has decided to invest again in structural funds over the next few years. But six months ago, we did not have any assurance about this. And after 2020, we do not know. The creation of a large structure, with competencies as specific as is the case with auditing EU funds, would have been risky’. (HAA at *Iris*)

However, the EU Commission raised a number of concerns about full outsourcing of the EU funds audit and demanded that an *Iris* manager should be assigned the responsibility for checking and validating the work of the external auditors. As a consequence, in 2003 the Cabinet entrusted a manager of the Territorial Planning Department with the responsibility for validating the work of external auditors. He had a Master’s Degree in Sociology and had previous work experience in other public administrations and in the Territorial Planning Department in *Iris*. At that time, he was in charge of monitoring changes and new developments concerning EU regulations; hence, he was already embedded in both the regional system and the EU system.

At the beginning of the 2007–2013 OP, the possibility of fully externalizing second level controls was no longer available, and the Cabinet chose to set up a small IA unit called the *Autorità di Audit* (Audit Authority), supported by two external auditing companies (one for each programme). The

purpose of the function was to perform second level controls on EU funds, as stated in the official presentation of the function:

‘The Audit Authority is fully dedicated to second level controls on activities co-financed through Structural European Funds. The core responsibilities of the office are defined by Article 62 of EC regulation no. 1083/2006 and consist of:

- Verifying the effective functioning of the management and control system of the operational programme through system audits;
- Performing ad hoc controls aimed at ascertaining the correctness and the admissibility of expenses related to the activities performed under the Operative Programme (audit on operations)’. (Official presentation)

The Audit Authority reported to the *Programmazione Territoriale* (Territorial Planning Department), which in turn reported to the *Giunta Regionale* (Regional Cabinet). The *Responsabile Autorità di Audit* (Head of the Audit Authority – HAA) was the same manager that had been in charge of coordinating the auditing of EU funds in previous years. He was chosen because of his experience as a ‘contact point’ with the external auditing companies and his background in the Territorial Planning Department. Other officers in the region openly recognized his experience in the field of EU funds, confirming that he had ‘considerable knowledge of EU funds’ and he had always been ‘particularly active in identifying and evaluating potential opportunities’ in this connection (Territorial Planning Officer).

The embeddedness of the HAA in the EU system influenced the choices he made to develop and improve the auditing of structural funds. The criteria used for staff selection reflected the Audit Authority’s focus on structural EU funds: the members of the team chosen by the HAA reflected his own background and embeddedness in the regional and EU system. They were all internal, and all of them had held previous positions related to EU funds, or they had specific competencies that could be useful for the funds audit (financial and statistical competencies). This choice made the

commitment of the HAA to this type of audit clear, and also signalled his lack of interest in extending the role of IA to areas other than EU funds. He appeared to be more comfortable dealing with EU funds than with other regional processes, since EU funds constituted the ‘bedrock’ of the Audit Authority’s competence profile.

During its first year of existence, the Audit Authority defined its work programme and prepared the audit manual. In this period, the HAA actively participated in a national project coordinated by the Formez, which formed a practitioners’ committee aimed at developing a set of guidelines for implementing new regulations on the role and responsibilities of the Audit Authority. The HAA became more and more embedded in this new institutional arrangement and began to consider that this committee was the Audit Authority’s main professional guide. In drafting the audit manual and the audit strategies of *Iris*, the HAA and his staff largely relied on the sample documents produced in this project. When discussing this experience, the HAA underlined the importance of creating a network of experts to support the identification of shared solutions to technical problems that might arise during audit activities.

‘This was a great opportunity for me, because I had the chance to discuss my concerns in relation to different matters that were new to us with my colleagues from other regions. Let’s think, for instance, of the issue of the sampling procedure and the need to set out an operational manual. All these things would have been overly complicated if I had to take care of them on my own’. (HAA at *Iris*)

At the end of the project, a permanent working group dedicated to auditing structural funds was established at the national level, and the HAA continued to take an active part in it. He often emphasized the importance of networking with the heads of the audit authorities of different regions in providing ‘technical guidance aimed at solving doubts and questions that might arise from the margins of discretion left by regulation’ (HAA). However, within this network of practitioners, he

established stronger connections with those colleagues that had developed a view of IA similar to his own view (i.e. focused on the auditing of EU funds). For instance, there was no evidence of cooperation with the CAE of *Dahlia* (who also participated in the network) or the Head of the MCU of *Tulip* (who did not participate in it). He named as his own reference people the heads of the audit authorities of other regions where IA appeared to be configured mainly for the auditing of EU funds.

Thus, at this point the HAA appeared to be focused mainly on dealing with uncertain expectations by participating in the development of a common approach to the audit of EU funds in the regions. This approach appeared to leave little room for developing an identity as part of the IA profession. The HAA contrasted the technical guidance provided by experts in the field of EU funds with the methodological guidance provided by the IIA. According to the HAA, the IIA can be considered a reference point for the ‘basic rules’ of IA, such as in the IIA standards and the code of ethics. However, as the HAA said:

‘The application of such principles to the audit object and in particular to EU funds is another issue which requires knowledge of the object that is going to be audited. From this point of view the IIA is not helpful’. (HAA at *Iris*)

Thus, the HAA distinguished between general internal audit knowledge and specific domain knowledge, recognizing the need for both in the audit of EU funds. However, the HAA largely associated the IIA standards with the attributes of internal auditors (e.g. independence, objectivity, ethics), that is, with ‘high level’ attributes of auditing with little direct influence on the actual audits. He considered the auditing of structural funds was a specific type of auditing with its own body of technical knowledge, that is, with knowledge of fund regulations and a deep understanding of all the dynamics of structural funds:

‘Internal auditing is a form of control of procedures that are to be performed according to IIA standards. EU funds auditing is different. In this case, IIA standards are just a methodological

reference, the core issue is the knowledge of the funding programmes. Internal auditing consists of checking procedures, which is part of auditing EU funds too. But when we do EU funds' auditing we go beyond this, because we try to find out if there is a margin for improving things'. (HAA at *Iris*)

This quote appears to show that in the HAA's mind, EU funds are the central activity around which methodologies and auditing tools should be modelled. The key issue is that 'the region is using EU funds and it is important to carve out the best from them, manage them properly, which means also auditing them *in a certain way*' (HAA). However, there also appears to be some definitional ambiguity (Englund *et al.*, 2013) in the HAA's understanding of IA in general as 'a form of control of procedures'. This understanding is not in line with IIA's definition of internal auditing or its standards, which focus much more on activities that can add value to the organization and improve governance mechanisms and operational processes. On the contrary, the HAA regarded EU funds' auditing as a means of creating value for the region. He claimed that auditing EU funds not only required an understanding of whether there is a potential risk or if something is going wrong, but also of whether there is potential for improvement, which suggests a concept of auditing that incorporates elements of both operational/performance auditing and the IA's consulting role. In the HAA's perspective, the idea that IA improves operations is associated strictly with the auditing of EU funds, as highlighted by the following:

'In a recent audit involving different provinces we found a very differentiated situation: some entities were working very well and other entities were working less well. We made the audit, we stressed potential problems when we thought it was necessary to do so, and we told those entities that were working well to go on like this. We could have stopped here. Our work was complete; we had done all that we are required to do according to the regulations. Instead we went further, and we suggested to the management authority that they should identify some best practices, because some entities were working really well, and they could become a

reference point for the others. We suggested that the management authority should produce guidelines that were more detailed than the existing ones to support those entities that were encountering more problems'. (HAA at *Iris*)

This approach was also echoed by the words of the member of the IA team who was involved in this specific intervention: 'the management authority started a gradual process of improvement that led to a closer connection with all the provinces, but in particular with the more problematic entities' (Member of IA Team).

The adoption of this particular concept of IA, which can ultimately be seen as a hybrid between EU funds' auditing and operational/performance auditing, drove the realization of some further adaptations of IA procedures. One example is the audit report and related documentation, which includes not only the evidence of the audit, but also the exchange of e-mails with suggested actions for improvement. Another example is the audit process itself, which included the fulfilment of 'mandatory' duties related to the requirements of the EU regulation, as well as the presence of less formal instances dedicated to the discussion of other areas for improvement. The latter is based on the use of 'soft' approaches to IA, relying more on open discussions and interviews than the formal methodology embraced for auditing EU funds.

It is also noticeable that these variations of practice were not determined by any perceived contradiction or tension between different institutional arrangements in which the HAA was embedded, and there was no evidence that he felt any incongruence between EU regulation and IA when auditing EU funds. Instead, he deployed the consulting role of IA in respect of auditing EU funds because this appeared to be in line with his own values, both in terms of feeling comfortable in the field of EU funds and aspiring to 'to carve the best out of [EU funds]' (HAA). The fragmentation of the institutional arrangements in which he was embedded enabled him to do so, as a unique definition of IA was missing, thus creating definitional ambiguity (Englund *et al.*, 2013). This left

room for the HAA to configure IA in a way that was more consistent with his own aspirations and personal interests, and exclude those alternatives that were not in line with his values (Yang & Modell, 2013).

When questioned about the possibility of applying the auditing approach used on EU funds to other processes in the region, the HAA expressed reservations about the possibility of achieving the same degree of knowledge and understanding of other regional processes as that achieved in connection with structural funds, as the following extract shows:

‘Interviewer: Do you think that you could possibly apply the same auditing approach used for structural EU funds to other processes in the region, such as transportation, health care..?’

Interviewee: I never thought about this possibility, but I would say no. We couldn’t do the same thing for different regional processes because it would be too superficial. To use the same approach, we would have to develop very specific competencies about each regional process. When we do an audit on ESF, we know that programme as much as or better than those we audit. How could we do the same on transportation? If I think of an IA unit which was to do internal auditing on transportation, health care, cultural heritage, agriculture... I wonder how it would be possible. It would be necessary to establish a titanic function. But even if this was the case, I think that it would have to remain at a superficial level. And in that case, is it worth it? I do not know’. (HAA at *Iris*)

Hence, from the HAA’s perspective, extending the scope of IA beyond auditing EU funds is at odds with IA’s potential for ensuring the IA accountability role and contributing to process improvement. On the one hand, he considered the extension of IA to other processes to be close to the original idea of a control and monitoring function aimed at reducing the information asymmetry between senior managers and division managers and curbing their self-serving interests; on the other hand, there is evidence that the HAA was not comfortable with expanding the audit beyond the field of EU funds, in which he was deeply embedded.

6. Concluding discussion

This analysis of internal auditing (IA) in the three regions studied has revealed three different ways of understanding and practising IA: an assurance and consulting activity applicable to both EU funds and other regional activities in *Dahlia*; a compliance activity in *Tulip*; finally, a specialized activity to be performed on EU funds in *Iris*. These different IA roles are reflected in the practice variations that emerged as an outcome of the agents' multilayered embeddedness in multiple institutional arrangements.

In *Dahlia*, the CAE's embeddedness in the *region*, the *EU system* and the *IA profession* informed the gradual evolution of IA in terms of both the object of IA activities (EU funds versus other regional activities) and the type of internal audits performed (financial versus operational auditing and assurance versus consulting role of IA). Being embedded in the EU system, the CAE started to consider the possibility of extending IA to other regional activities, as he came to regard the role of purely structural funds' auditing as suboptimal compared to the region's core activities. He also participated in the IIA's activities, where he gradually developed his professional identity as an internal auditor. This resulted in a perceived tension in the role of IA between a remit focused on the provision of assurance services in the financial sphere and an extended role which included the provision of consulting services provided in connection with operational processes. Furthermore, the extended role of IA was more in alignment with the CAE's system of values, which appeared to be sensitive to the issue of transparency and accountability, but also oriented towards finding new managerial solutions (Yang & Modell, 2013). In particular, the CAE felt he could be more effective and secure a better position for IA by promoting the extended view of IA's role. Hence, he took 'purposive action' (Englund & Gerdin, 2011, p. 586) driven by a desire to change current structural arrangements. Drawing on his multiple memberships, the CAE exploited structural elements of the

EU system and the professional body in order to legitimate certain actions in the focal system of the region (Englund & Gerdin, 2011). The CRSA project provides a significant example of how the CAE exploited structural elements of the EU system to develop IA within the region. The references to the IIA's professional standards and the development of the competence profile of the internal auditors are examples of how he exploited structural elements of the professional body to model IA in *Dahlia*.

The situation was different in *Tulip*, even though the evolution of IA had again been informed by the Head of the MCU's multiple embeddedness in the in the *regional system*, the *EU system*, and the *chartered accountancy profession*. In the initial phase, the 'core values' that characterized the different institutional arrangements were in line with the idea that IA's role is limited to the auditing of EU funds. This narrow scope of IA's role was in accordance with the personal interests of the Head of the MCU, who considered the management accounting domain to be the main source of his systemic power (Yang & Modell, 2013). However, the choice of configuring IA as the auditing of EU funds had some unintended outcomes. As Englund and Gerdin (2011) have pointed out, 'even in the absence of attempted change, the unintended consequences [of prior choices] may produce structural change as agents are "forced" to relate to the new and unforeseen conditions produced by their own previous acts' (p. 590). A scandal over the allocation of financial contributions made the Head of the MCU and the leaders of the region reflect on the choice of focusing IA on the auditing of EU funds without implementing control mechanisms in other regional activities. This circumstance determined a change in the focal social system of the region, and a renewed focus on transparency and control and helped pinpoint some of the contradictions between the current role of IA, which is limited to structural funds, and its potential role in preventing and detecting fraud in other regional activities. In the end, this led to the emergence of a different type of IA, in the form of 'audit on demand'. Once again, the (limited) development of IA was shaped by the CAE's personal interests and the existence of a certain 'definitional ambiguity' (Englund *et al.*, 2013) about what IA should

be. He did not do anything to transform the audit on demand into something more formalized, since he perceived that the extension of IA would potentially overlap/compete with management accounting's role (Yang & Modell, 2013).

Finally, in *Iris*, the HAA was embedded in the *region*, the *EU system*, the *network of audit authorities* responsible for structural funds, and the *IA professional body*. However, in this case, it was clear that he relied on the EU system and the network of audit authorities much more than on the professional body and, in general, he appeared to be 'more comfortable' when dealing with the world of EU funds, since they represented the bedrock of his competencies. Hence, contrary to what happened in *Dahlia*, he did not draw on the IA professional body or exploit the EU structure to change the role of IA in the region, but he used EU regulation as a lever to legitimate his choice of keeping IA focused on its original area of responsibility, the EU funds' audit. On the other hand, he was a proactive agent, combining the set of rules embedded in the region and derived from the EU system with other available schemas, looking for a way to improve technical efficiency, with the result that he integrated some principles of operational/performance auditing into the set of rules derived from auditing EU funds. Related to Englund and Gerdin's (2013) framework, the HAA took the opportunity to combine and extend the set of available procedures or schemes in a way that met his personal interests; that is, by keeping IA focused on auditing EU funds and introducing some forms of consulting services in relation to this specific area of responsibility.

Looking at the influence of the embeddedness of agents in multiple institutional arrangements on IA development has allowed us to address the problem of how and why variations in IA practices emerge from a different perspective than previous IA research. Previous literature, relying on either agency-centred or structure-centred frameworks, has analysed the influence of specific elements on the development of IA activities, such as the influence of regulation (Al-Twaijry *et al.*, 2003; Arena *et al.*, 2006) and the professional body (Rittenberg & Covaleski, 2001; Arena & Jeppesen, 2010), and

tensions between the IA assurance and consulting roles (Selim *et al.*, 2009; Stewart & Subramaniam, 2010). However, most of these works have considered these triggers separately, neglecting that tensions arise between and among different structures and result in the need to balance the influence of different institutional arrangements and the individual sets of values, which make the evolution of IA much more complex. The organizational characteristics of IA, both in the public and private sector, ensure internal auditors are naturally embedded in multiple institutional arrangements, whose core values may or may not be in alignment with each other and with the values of the individual internal auditor. The structural elements that characterize these different domains can also be subject to reciprocal influences because actors can pick up elements of structure from one domain and apply them in another one. This happened in the case of *Dahlia*, where the CAE relied on the EU system and the IA profession to shape IA in the region, but at the same time he became a leading figure within the professional body, potentially influencing how IA is carried out in other organizations. However, multiple embeddedness may also result in actors becoming more deeply embedded in one institutional arrangement while decoupling from others, as in the case of *Iris*, where the HAA was deeply embedded in the professional networks but was almost uninfluenced by the IA professional body. From this perspective, the development of IA is not only influenced by the actors' multiple embeddedness, but the different domains can also reciprocally influence each other, leading to further variations in practice.

The results of this comparison of IA in the three regions are not only interesting for IA literature, but also for institutional accounting literature in general, since they provide further evidence of the relevance of multiple embeddedness in explaining the rise of practice variations outside the management accounting domain in which the theory was mainly developed (Englund & Gerdin, 2011; Yang & Modell, 2013). In particular, this analysis may represent a first answer to the recent calls to identify some institutional contingencies that enable embedded agents to effect changes

(Englund & Gerdin, 2011; Yang & Modell, 2013). In this respect, this paper examines specific elements that enable and constrain changes in the three cases; it also pinpoints the significance of the interplay between actors' contemporary embeddedness in professional systems and the focal social system as a relevant source of practice variation. While previous studies of practice variation in the field of management accounting have emphasized the importance of definitional ambiguity, representational ambiguity, and operational ambiguity as drivers of change and variation (Englund *et al*, 2013), this case study of IA sheds some light on the types of contradiction that emerge when persons with mixed professional identities are involved in a field. From the cases considered, it appears that professional identity is an important carrier of institutions (Scott, 2003), which in the IA domain appears to create perceived contradictions between professional ideals and organizational practices. Thus, we suggest the addition of 'professional ambiguity' as a fourth category of ambiguity, defined as uncertainty about professional identity, which is triggered by multiple embeddedness in professions and organizations without professional dominance, or in different professions. Professional ambiguity may in turn lead to reflexivity about the appropriateness of the professional identity and the professional standards framework that are part of this, which may be a source of practice variation. In addition, professional ambiguity may in turn also create elements of reflexivity regarding the definition and scope of IA, operational reflexivity regarding the influence of IA practices, and perhaps even representational reflexivity regarding IA's role in creating perceived realities in organizations. Such reflexivity is likely to lead to the formation of contradictions that trigger practice variation.

Our study of the emergence of practice variation in IA has two implications for future research. Firstly, it suggests that further insight can be gained from applying practice variation theory to financial accounting and auditing research, in addition to management accounting. Secondly, such

analysis needs to take account of how issues of professional identity and professional competition influence the formation of contradictions that trigger practice variation.

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Table 1. Case settings and interviews

| | Population | Number of municipalities | Interviewees | Number of interviews |
|--------|-------------------------|---------------------------------|---------------------------------------|-----------------------------|
| Dahlia | More than 5 million | More than 500 | Chief Audit Executive | 3 |
| | | | Head of Audit Authority | 2 |
| | | | Integrated Planning Officer | 2 |
| | | | Head of Management Authority | 1 |
| | | | Internal Controls and Privacy Officer | 1 |
| | | | Member of IA Team | 1 |
| | | | Divisional Manager | 1 |
| Tulip | Between 2 and 5 million | More than 500 | Head of Management Control Unit | 2 |
| | | | OP Officer 1 | 1 |
| | | | OP Officer 2 | 1 |
| | | | Head of Finance | 1 |
| | | | Finance Officer | 1 |
| | | | Divisional Manager | 1 |
| Iris | Between 2 and 5 million | Between 300 and 500 | Head of Audit Authority | 2 |
| | | | OP Officer 1 | 2 |
| | | | OP Officer 2 | 2 |
| | | | Territorial Planning Officer | 1 |
| | | | Member of IA Team | 1 |

Table 2: Expected role of IA in different institutional arrangements

| Institutional arrangements | Expected role of IA |
|-----------------------------------|---|
| IA professional system | <i>With reference to IA 'in general':</i> To help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes (IIA 1999). <i>With reference to public sector IA:</i> To protect the public interest, provide a range of assurance and consulting services, such as financial certification and operational functional efficiency, and to address all the purposes of the governance activities (AIIA 2008). |
| Public sector reform | To verify the effectiveness and efficiency of administrative and financial controls (286/1999). Not defined (150/2009). |
| Regional system | Not defined. |
| EU funds system | To verify the effective functioning of the management and control system of EU funds (EC Reg. 1083/2006). |