

Corruption and Public Sector Auditing: A Review of Related Literature

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Abstract

In both industry and academics, there has been a lot of discussion on how auditing might lessen corruption. The current study's goal is to evaluate the most recent developments and knowledge gaps on the relationship between public sector auditing and corruption. It is based on assessments of the academic literature we thus make broad generalizations about the state of the most recent discoveries. The earlier writing on corruption emphasized political and economic viewpoints. There is still a significant knowledge vacuum in this field, particularly with regard to the practical role of public sector auditing in corruption detection and deterrent in developing countries, despite the fact that data suggests that it aids in the fight against corruption. Furthermore, there is a paucity of literature that explains in detail how audit types conducted by the Supreme Audit Institution (SAI) may contribute to a reduction in corruption, as well as which audit types are more effective. There is also very little in-depth discussion of the difficulties that public sector auditing faces in detecting and preventing corruption. The study therefore recommends that the role of auditing should be given much attention on how to combat corruption; auditors' independence should be strengthened and sustained in public sectors, most especially in developing nations which is certain to provide the liberty and lack of restrictions the auditors need from undue influence and interference from any party and to remain unbiased in discharging their audit obligations.

Keywords: corruption, public sector auditing, supreme audit institution (SAI)

Introduction

The media's increased focus on corruption over the past 20 years shows that developing nations are particularly vulnerable at this time. According to the Corruption Perception Index (CPI), developing nations require efficient anti-corruption tools. In fact, a significant number of the G20 countries and more than 66% of the world's nations suffer from the negative effects of corruption (Enste & Heldman, 2017; Othman, Aris, Mardziyah, Zainan, & Amin, 2015). Corruption is not a recent societal phenomenon; in fact, it predates government itself and must be noted (Othman, Shafie, & Zakimi, 2014; Klitgaard, 1988). The United Nations lists combating corruption as one of its seventeen sustainability development goals;

recognizing it as a serious worldwide problem. It is essential due to the debilitating effects of corruption, which hinder a nation's development by skewing public spending and markets, slowing down economic growth, undermining the rule of law and democracy, and degrading the standard of living (Enste & Heldman, 2017; Othman *et al.*, 2015). According to the Dye (2007), it has deep roots in political and administrative institutions, and depending on the country context, it has different effects on development. While corruption has detrimental impacts in rich countries as well, these effects are felt most acutely there (Rady, 2016), and there is considerable worry about how to address this epidemic's threat in poor nations (Othman, Shafie, & Zakimi, 2014).

According to Everett, Neu, and Rahaman (2007), some significant institutional actors have recently become actively involved in the fight against corruption. These developments may be observed in the International Convention against Corruption, which entered into force on October 31, 2003 (Transparency International, 2005; United Nations, 2004). Moreover, international interests in battling corruption and enhancing accountability in the public sector led to the creation of a significant organization, the International Organization of Supreme Audit Institutions, as early as 1953. This organization, which oversees the affairs of the community of government auditors, has 190 full members. In order to ensure that knowledge is shared, auditing is practiced, and professional capacities are enhanced, the institution has over many years developed a solid foundation for government auditing. It is encouraged for Supreme Audit Institutions (SAIs) members to develop within their own nations (INTOSAI, 2015). As a cornerstone and crucial component in the fight against corruption in the public sector, good public sector auditing is shown in the literature to have a significant impact on domestic levels of corruption (Hay & Cordery, 2018; Gustavson & Sundstrom, 2016). The public also expects the auditors to play an effective role in reducing, if not completely eliminating, corruption (Otalor & Eiya, 2013). This expectation results from the belief that the audited data is fairly accurate, comprehensive and objective. An essential part of accountability is auditing since it validates the data that forms the basis of formal and financial accountability (Power, 1997). As a result, the audit profession aids public sector organizations in achieving accountability and integrity, enhancing operations, and fostering public trust. In order to prevent and identify public corruption, one of the responsibilities of the public sector auditor is to act as an organization regulating how public sector organizations behave, particularly with relation to public funds (Goodson, Mory, & Lapointe, 2012;

Guthrie, Petty, & Johanson, 2001). In order to combat corruption in the public sector, the populace expects auditors to play a crucial role.

In Nigeria, there is evidence of weak accountability in the public sector (Appah, Onowu, & Adamu, 2021). In order to accomplish effective control and management of public funds, this necessitates proper and comprehensive auditing as well as efficient execution of the government's defined rules, procedures, and activities. The public sector audit is a method for determining the genuine financial standing of governmental organizations (Ferry, Radcliffe, & Steccolini, 2022; Appah *et al.*, 2021). Although public sector auditing plays a crucial role in ensuring accountability, this has not been sufficiently demonstrated in most developing Nations. In order to achieve financial accountability and performance, the Nigeria government has committed significant financial and non-financial resources to the public sector organizations. Sadly, financial theft, misallocation, and embezzlement continue to plague public sector organizations (Appah *et al.*, 2021). Moreover, little research has been done on how public sector auditing affects corruption (Gustavson & Sundstrom, 2016). Additionally, many of these scant studies fail to address why corruption is still on the rise in certain developing nations that have SAIs, which are in charge of auditing the public sector. Few studies have examined how public sector auditing combats corruption, including the difficulties it faces and the benefits each style of auditing brings (Al-Sadig; 2009).

This article is based on the analysis of three types of literature: academic and scientific works on corruption, works on public sector auditing, and works that link corruption and public sector auditing. This sort of analysis will highlight any gaps in the body of knowledge and suggest new research ideas.

Literature Review

Public Sector Audit: Concept

According to Gekula and Isanzu (2020), a public sector audit is an examination of the performance of the public sector that looks at specific financial operations as well as every aspect of governmental operations, including organizational and administrative structures. However, Appah (2017) asserted that public sector auditing comprises looking at financial and non-financial data that public sector organizations are expected to have audited. It is done to make sure that sufficient financial records are kept in order to support correct accountability, public stewardship of public funds, prevention of misappropriation of public funds,

compliance with proper norms of behavior, and support public sector enterprises in achieving value for money (Appah & Zibaghafa, 2018; Appah, 2017).

Corruption: Description

Despite being a long-standing problem (Othman *et al.*, 2014), corruption has grown internationally, causing poverty by interfering with social, economic, and political systems (Otalor & Eiya, 2013). It has gotten out of control and is now an epidemic that harms society, undermines democracy and the rule of law, skews markets, and lowers quality of life (United Nations, 2004). However, Growth and development are inversely correlated with corruption (Papaconstantinou, Tsagkanos, & Siriopoulos, 2013; Rady, 2016). Due to the higher entry costs and functioning in a corrupt environment, corruption also contributes to a decline in both domestic and foreign investment (Ahmadi & Homauni, 2011; Myint, 2000). According to Jetter, Agudelo, and Hassan's (2015) research, democracy may reduce corruption in wealthy nations, while increasing it in less wealthy nations due to disparities in income levels. Political instability results from corruption, which decreases public confidence in democratic government institutions and imperils the authority of the executive branch (Nwabuzor, 2005). Gounev, Dzhekova, and Bezlov (2012) made the argument that high levels of corruption promote the growth of bribery and nepotism in the delivery of public services by lowering the quality of bureaucratic processes. Without regard to the effectiveness, capacity, or credentials of the person being hired, employment in public service institutions may itself be based on bribery or nepotism.

Unbelievably, corruption may also affect how government budgets are generated and used in terms of revenue and expenditure. For example, it has an impact on how customs duties, taxes, dues, and fees for public services like power and water supply are collected (Myint, 2000). Purchasing excessive amounts of weaponry under the guise of preserving national security is only one example of how corruption persists and can be deceiving (Myint, 2000; Shleifer & Vishny, 1993). Investment in public infrastructure, which requires additional funds, can be put on hold, resulting in production of worse quality (Everett, *et al.*, 2007; Tanzi & Davoodi, 1998). As they believe there is less chance for fraud in programmes for rural development, textbooks, teacher salaries, training and development, and preventive healthcare, officials frequently prefer to spend money on infrastructure instead of health or education projects (Myint, 2000).

Corruption and Public Sector Auditing

Auditing is a crucial component of fighting corruption, as has already been demonstrated (Otalor & Eiya, 2013). Khan (2006) states that, auditing is crucial in battling corruption in the public sector, and auditors and the audit profession in general play a vital role in lowering fraud and corruption. This also supports the idea that improved public sector auditing appears to have a substantial impact on lowering overall corruption levels in a country (Dipietro, 2011). Ionescu (2014) makes a similar case that government should create an effective auditing system that can be utilized for checks and balances as well as for fraud detection. Such systems should aid government auditors in spotting corrupt practices and preventing major potential economic deficits.

The International Standards of Supreme Audit Institutions (ISSAIs) goals serve as a representation of the role of public sector auditing by SAIs. According to the Fundamental Principles of Public-Sector Auditing published by ISSAI, public sector audits share similar goals, albeit the precise goals and results can vary depending on the type of audit being conducted (Appah, Onowu, & Adamu, 2021). Four guiding concepts are, nonetheless, present in all public sector audits. First, public sector auditing offers all possible users unbiased, impartial, and trustworthy data based on enough and pertinent evidence pertaining to public bodies. Second, it promotes accountability and transparency, fostering ongoing improvement and maintained confidence in the effective use of public resources and management. Thirdly, it increases those bodies' capacity for action within the framework of the constitution. Last but not least, it provides information, in-depth analysis, and well-supported suggestions for improvement to encourage change (ISSAI 100, 2013).

As it supports the governance functions of insight, foresight, and supervision, to which they added detection and prevention, auditing, according to Goodson *et al.* (2012), is a basic component of effective government. Since the public sector's success is primarily determined by its ability to effectively provide services to the general public and carry out its programmes in an equitable manner, it is crucial that the activities of public sector audit are focused on assessing the level of compliance with financial programmes and measuring the efficiency, effectiveness, and economy of those activities. The primary principles of government, which benefit all citizens, must be safeguarded by the auditors.

According to a large body of research, auditing plays a significant part in the battle against corruption in the public sector (Rana, Steccolini, Bracci, & Mihret, 2022;

Themsen & Skærbæk, 2022; Khan, 2006), and in particular, higher-quality auditing in the public sector has a noticeable impact on lowering national corruption (Dipietro, 2011). According to Tara, Gherai, Droj, and Matica (2016), SAIs boosts governmental organizations' productivity and lower perceived levels of corruption. In a different study, Gherai, Tara, and Matica (2016) found that as SAIs increase the scope of their activity, corruption declines. Government auditors should identify corrupt bureaucracies, according to Ionescu (2014), by doing competent auditing within the framework of checks and balances and fraud detection.

In their panel data study, Liu and Lin (2012) determined that the amount of anomaly found in government records by auditing is directly and strongly correlated with the level of corruption. This suggests that there is a greater chance that anomaly will continue to be found by regional audit agencies the more corruption there is in the government authorities. These results suggest that audit in the public sector plays a crucial part in identifying corruption there (Rana, Steccolini, Bracci, & Mihret, 2022; Themsen & Skærbæk, 2022; Assiotis & Sylwester, 2014; Kumlin & Esaiasson, 2012; Chang & Chu, 2006; Bowler & Karp, 2004; Anderson & Tverdova, 2003). The public sector audit is one of the tools for combating corruption, according to Otor and Eiya (2013), and it is effective in lowering, if not completely eliminating, corruption. Therefore, the fight against both internal and international corruption should centre on auditors (Kassem & Higson, 2016; Everett *et al.*, 2007).

The recommendation made by Albrecht, Albrecht, Albrecht, and Zimbelman (2012) that possibility for fraud to be committed should be eradicated and this will serve as a preventative strategy against corruption in the public sector. By establishing reliable internal controls, reducing public officials' and citizens' collaboration, and clearly communicating the government's anti-fraud regulations to vendors and other contractors, such chances can be avoided. The monitoring of employees through hotlines (whistle-blowing systems) for anonymous tips and the establishment of a punishment expectation will take place. According to Khan (2006) putting a performance audit into place can help to lessen corruption by acting as a deterrent to such behaviour. Thus, performance audits can be a unique and effective tool for preventing corruption (Otor & Eiya, 2013).

Khan (2006) contends that while auditors can identify potential areas for corruption, they are unable to assist in its detection because corrupt individuals frequently hide any evidence of their actions in official records. According to

Albrecht *et al.* (2012), auditors must assist in identifying red flags or indicators of fraud and further explore these indicators to determine if they are a result of genuine fraud or are the result of other causes. Nevertheless, it is regrettable that a number of fraud signs frequently go unrecognized and those that are identified are not always rigorously followed. It is crucial to note that if fraud signs had been looked into sooner, many frauds would have been discovered. These fraud red flags or signs might take the form of accounting irregularities, internal control issues, anomalous data, expensive lifestyles, strange behaviour, tips and complaints (Albrecht *et al.*, 2012).

Khan (2006) concluded by saying that the SAI is one of the most crucial organization that can aid in lowering corruption in the public sector. The SAI itself must be reliable and well-funded for this purpose. So that the SAI can effectively play its part in the fight against corruption, he suggests eight measures for its improvement: fostering its independence; enhancing its authority; implementing participatory auditing; reviewing procedures and auditor training; establishing and upholding an ethics code; improving the SAI's performance; and cooperating and coordinating with other parties.

Methodology

The study adopted qualitative research approach (Kothari, 1990); more particularly, a content analysis of prior research on public sector auditing and corruption. This method helped the researcher systematically examine a body of material to identify public sector auditing and corruption patterns. The study identifies peer-reviewed journal publications published in consonant with Public Sector Auditing and Corruption between 1983 and 2022. The modus operandi was chosen to make it easier to explore the literature that is currently available on Public Sector Auditing and Corruption.

Discussion of Findings

Majority of studies describe the connection between corruption and the economy, according to a review of the literature. Some studies found that corruption impedes or dampens economic growth and national development (Rana *et al.*, 2022; Thomsen & Skærbæk, 2022; Appah *et al.*, 2021; Assakaf, Shamsiah, & Othman, 2018; Enste & Heldman, 2017; Borlea, Achim, & Miron, 2017; Ata & Arvas, 2011; Al-Sadig, 2009; Lambsdorff, 2005; Myint, 2000). Additionally, it might alter how the government spends its money (Lambsdorff, 2005; Myint, 2000) and decrease tax collections (Friedman, Johnson, Kaufmann, & Zoido-Lobaton, 2000; Tanzi &

Davoodi, 1998; Johnson, Kaufmann, & Zoido-Lobaton, 1998). The political system, public trust in the government, and democracy are all negatively impacted by rising levels of corruption (Assiotis & Sylwester, 2014; Kumlin & Esaiasson, 2012; Chang & Chu, 2006; Bowler & Karp, 2004; Anderson & Tverdova, 2003). Political instability may result from these factors (Assiotis & Sylwester, 2014; Nwabuzor, 2005; Treisman, 2000).

There were several suggestions for reducing corruption discussed. Ionescu (2016), for instance, investigated the relationship between corruption and information and communications technology (ICT), e-government, and both. Ionescu's findings, which are based on data from a survey of the top 20 nations according to the UN's 2012 E-Government Readiness Index, show the effectiveness of ICT-related e-government as an anti-corruption strategy. Similarly, Kim, Kim, and Lee (2009) discovered that e-government anti-corruption systems have a beneficial effect on the decline in corruption.

Murphy (2004) said that corruption occurs when there is a lot of room for it to happen. As a result, organizations fighting corruption must employ a multifaceted strategy that tries to lessen the possibilities and rewards for corruption, while raising the expected cost of dishonest behaviour. According to Shleifer and Vishny (1993), political and economic competition can lessen corruption's prevalence and damaging effects. Olken (2009) came to the conclusion that the average person today lacks the ability to adequately monitor local politicians and spot corruption without any outside help. This demonstrates the importance of transparency since it increases the ability of the public to spot and condemn wrongdoing at all levels.

The public sector auditing out of corruption cases has been the subject of numerous studies (Hay & Cordery, 2018; Goe & Singh, 2012; Schelker, 2012; Saito & McIntosh, 2010; Schelker & Eichenberger, 2010; Gendron, Cooper, & Townley, 2007; Ma, 2007; Santiso, 2007; Waring & Morgan, 2007; Neu, 2006; Zhao, 2005; Yoshimi, 2003; Gendron, Cooper, & Townley, 2001). For instance, Zhao (2005, cited by Liu & Lin, 2012) proposed a fairly comprehensive framework of characteristics that classifies the variables influencing the calibre of government audit into three groups: technical variables (professional competence, auditor size, and audit hours), independence variables (audit fee, auditor reputation, and organizational design of audit institutions), and administrative variables (determining the nature of irregularities, making the right decisions and checking on rectification results). When measuring the quality of government audits in

empirical studies, researchers frequently utilize only one of these traits as a proxy. For instance, Saito and McIntosh (2010) used auditing time as a direct indicator of auditing effort. On the other hand, Ma (2007), cited by Liu & Lin, (2012) revealed that professional skill, experience, and educational background are highly associated to the financial effectiveness of government auditing.

State audit budgets and indices of political rivalry showed favourable associations when Baber (1983) analyzed cross-sectional data from state governments. These findings are in line with the concept that contracts between public officials and their supporting interests are what motivate them to do audits. In a similar spirit, Gendron *et al.* (2001) asserted that the Canadian Office of Auditing strengthened its ability to persuade politicians and other public officials of the virtues of its particular interpretation of what accountability ought to entail. However, when an Office gains in strength, concerns regarding a perceived lack of executive independence against it also increase.

In order to understand the function and effectiveness of government external audit agencies in the management of the budget and the oversight of public finances, Santiso (2007) examined the connections between external auditing and fiscal governance. He discovered a connection between the level of governance's credibility and the external audit agencies' credibility. It was also determined that deeper dysfunctions in the systems of fiscal management are the root cause of accountability gaps in public finances. According to Schelker and Eichenberger (2010), such audits increase transparency and offer crucial information on how policy ideas would affect resources in the common pool, which reduces wasteful expenditure. They also discovered that there was a considerable decrease in overall taxation and public spending when auditors were able to assess and criticize policy ideas prior to policy choices. The importance of financial statement auditing in the public sector was finally explained by Hay and Cordery (2018) using a historical study. They came to the conclusion that agency theory and management control explanations are congruent with the public sector auditing functions.

Studies linking auditing to corruption have been published in the public sector auditing literature (Gherai *et al.*, 2016; Gustavson & Sundstrom, 2016; Kassem & Higson, 2016; Tara *et al.*, 2016; Othman *et al.*, 2015; Ionescu, 2014; Neu, Everett, & Rahaman, 2015; Neu, Everett, & Rahaman, 2013a; Neu, Everett, Rahaman, & Martinez, 2013b; Otalor & Eiya, 2013; Liu & Lin, 2012; Blume & Voigt, 2011; Dipietro, 2011; Ferraz & Finan, 2011; Dye, 2007; Everett *et al.*, 2007; Olken, 2007;

Khan, 2006; Dye & Stapenhurst, 1998). The value of public sector audits in preventing corruption has been empirically examined in a number of studies. In order to study the relationships between the existence and operation of the Supreme Audit Institutions and the prevention of corruption, Gherai *et al.* (2016) used a statistical technique. According to their findings, the SAIs' work contributes to reduce corruption and is positively correlated with a higher quality of life the more extensive it is. That report didn't go into detail about how SAI works to lessen corruption in the public sector or the techniques employed to detect and prevent it. In order to investigate the methods of fraud and corruption detection and prevention in Malaysia's public sector, Othman *et al.* (2015) used structured questionnaires. The study's conclusions showed that the operational audits, Whistle-Blowing system implementation, improved audit committees, staff rotation improved internal controls, fraud hotlines, and forensic accountants are some of the most efficient fraud detection and prevention methods used in the public sector. Othman *et al.* (2015) did not distinguish between the mechanisms used in detection and the mechanisms employed in prevention. They also did not go into great detail on the state of affairs in which each mechanism was used or the difficulties that each faced. In a similar vein, Gustavson and Sundstrom (2016) looked into the effect of SAI audits in the public sector on the level of corruption. According to their findings, the level of corruption in the public sector is positively impacted by effective auditing carried out by SAIs. They also discovered that a number of factors, such as SAIs' independence from the government, the professionalism of SAIs through hiring personnel with the necessary training and education, and SAIs' public disclosure of audit findings, all contribute to the reduction of corruption in the public sector.

In order to demonstrate that better auditing lowers corruption, Dipietro (2011) conducted cross-sectional research from several nations. In other words, higher quality auditing appears to have a significant impact on lowering national corruption. On the other side, Liu and Lin (2012) concentrated on rectification and suggested that it is even more crucial to address errors following an audit than the fraud detection procedure itself. They stated that the identification of abnormalities without a plan for how to fix them prevented government auditing from serving as a potent system of accountability. They assert that rectification, which includes "asking for accountability," is successful in lowering corruption. Government auditing can increase the transparency of public policy and decrease unnecessary spending, according to Blume and Voigt (2011) and Schelker and Eichenberger (2010). An earlier study by Olken (2007) on the monitoring impact of government

audits in Indonesia found that when village road projects were more likely to be audited by the government, corruption (excess spending on these projects) dropped by 8%. Similar to this, Ferraz and Finan (2008, 2011) discovered that government auditing reports can point out corrupt practices, which consequently have an impact on the outcomes of political elections.

Additionally, numerous researches have conceptually supported the significance of public sector audits in the battle against corruption. For instance, Ionescu (2014) concluded that audit institutions cannot sufficiently reduce corruption in government institutions by exposing wrongdoing during the audit of government accounts. Governmental wrongdoers can be deterred from engaging in corrupt behaviour by enforcing violations and correcting errors. It was therefore stated that where such rectifications are made, with an emphasis on efficiency, the rate of corruption can be successfully minimized. Otalor and Eiya (2013) added that audit could be a tool for preventing corruption by highlighting those places where the potential for wrongdoing exists. Additionally, they confirmed that the performance audit is a potent tool that may be utilized to fight corruption. Murphy (2004) showed that in order to effectively combat corruption in the public sector, anti-corruption programmes must work to lessen or eliminate the incentives and opportunities for it, while also raising the costs associated with it and influencing public perceptions.

Conclusion and Recommendations

There is little doubt that many studies individually explore corruption, its causes, and its motivations. Nevertheless, the majority of the research on corruption concentrated on the results and repercussions from an economic perspective. The role of auditing is generally not given much emphasis in research on how to combat corruption. The literature on public sector auditing focuses predominantly on the standards, independence, professionalism, and auditing input of government auditing agencies; and how these aspects affect the standing and effectiveness of governmental departments (e.g., Schelker, 2012; Saito & McIntosh, 2010; Raman & Wilson, 1994; Baber, 1983). Additionally, it was discovered that majority of empirical research on corruption were carried out in industrialized nations as opposed to those that actually deal with the issue, such as Neu *et al.* (2013a, 2013b). Also, majority of these research lack empirical data (e.g., Ionescu, 2014; Otalor & Eiya, 2013; Dye, 2007; Khan, 2006; Dye & Stapenhurst, 1998). Few, if any, made a significant effort to explore in depth the challenges that public sector auditing faces in its role of detecting and preventing corruption, particularly in developing nations. No one attempted to answer the question of how public sector auditing

detects and prevents corruption in depth. In order to close this significant gap in the literature, further study should be conducted.

Hence, the study therefore recommends that the role of auditing should be given much attention on how to combat corruption; auditors' independence should be strengthened and sustained in public sectors, most especially in developing nations which is certain to provide the liberty and lack of restrictions the auditors need from undue influence and interference from any party and to remain unbiased in discharging their audit obligations.

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