

THE EFFECT OF AUDIT LEGAL FRAMEWORKS ON PUBLIC EXPENDITURE MANAGEMENT (THE CASE OF PUBLIC SECTOR ENTITIES IN ETHIOPIA)

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ABSTRACT

The study aimed to examine the effect of audit legal frameworks on public expenditure management in public service entities in Ethiopia. Both primary and secondary data were used to carry out this study. The primary data was collected from 136 randomly selected auditors from the Office of the General Auditor (OFAG). Secondary data were collected from the review of related literature. A structural equation model was used to investigate the relationship between public sector audit legal frameworks and public expenditure management. The findings of the study revealed that audit legal frameworks have both direct and indirect effects on public expenditure management in public sector entities. The audit legal frameworks improve the audit quality of the office and also create a deterrent effect on parties involved in the management of public expenditures. The legal department of the office should design a system to collect information on the loopholes in the audit legal framework, review them, and provide solutions accordingly. This paper contributes to the literature on the role of auditing in the management of public expenditures.

Key words: audit, expenditure, legal-framework, structural, and deterrent

JEL classification: H83, G32

1. INTRODUCTION

An audit is an objective assessment of a company's financial statements with the aim of forming an opinion about the statements' accuracy and fairness. Generally, audits are conducted to give financial statements legitimacy for use by parties other than those who prepared them (Okafor, 2011). Public-sector auditing can be defined as a systematic procedure for impartially gathering and assessing data to ascertain if facts or real circumstances meet predetermined standards.

Public-sector auditing is crucial because it offers information and independent and objective judgments about the management and execution of government policies, programs, or activities to those in charge of governance, the legislative and oversight bodies, and the general public (INTOSAI, 2019). The purpose of auditing is to gather the data required for performance reports and to provide independent assurance that public sector activities are "fairly" reflected in accounting statements and reports provided by management. The aim of statements is to provide information, comments, and suggestions that will enable Parliament to examine government operations, government review management operations, and management review authority or department activities (Nosworthy, 1999).

In the public sector, auditing is an important component of the financial system. The actual function of audit has evolved over time from simple detection-focused processes to a performance assessment method that emphasizes advocacy and prevention. The audit institutions are working to cover more pertinent financial sector responsibilities in order to assure the responsibility of the budget recipients in response to this changing situation (Matendera, 2013). Since the management of public resources is an issue of trust, public-sector auditing is crucial for the public administration. An organization or individual acting on behalf of the public is given the duty of managing public resources in accordance with their intended uses. By providing information and unbiased, independent assessments of violations of established norms or good governance principles, public sector auditing builds the intended users' confidence. Supreme audit institutions (SAIs) are a country's highest-ranking public-sector auditing body. Their primary function is to assess whether public funds are being used effectively, economically, and efficiently while adhering to existing laws and regulations.

The effectiveness of controls can be confirmed, waste can be found, and improvements to the performance of government organizations can all be made with the help of well-functioning SAIs. They can aid in the fight against poverty and national development by ensuring that money is wisely spent (OECD, 2010). The term "accountability" refers to the organizational structure, strategy, processes, and activities that help ensure that Supreme Audit Institutions (SAI) fulfill their legal requirements. It also refers to the legal and reporting framework. Along with overseeing the operations of its own office, the Office of the Auditor General (OAG) is mandated to use its discretion to ensure accountability in other public organizations (Nosworthy, 1999).

The Ethiopian government recognized the need to provide citizens with effective, efficient, and timely public service as part of its objective to improve overall public service performance. Economic prosperity, which serves as a measurement of the living standards of the people under a specific policy, is strengthened by the power of oversight bodies like the Office of the Auditor General. According to the Ethiopian constitution 1994 article 101 subarticle 2, The office of Auditor General of Ethiopia shall audit and inspect the accounts of ministries and other agencies of the Federal Government to ensure that expenditures are properly made for activities carried out during the fiscal year and in accordance with the approved allocations, and submit his reports thereon to the House of Peoples' Representatives.

1.1 The problem Statement

The leading public sector audit bodies in a nation are the Supreme Audit Institutions (SAIs) in many countries and office of auditor general (OFAG) in some countries. Their main responsibility is to determine if public monies are used effectively, economically, and efficiently while adhering to all applicable laws and regulations as well as the priorities of the country. They achieve this by providing impartial, thorough audit reports designed to improve how governments handle public resources. By ensuring that money is wisely spent, they can prevent fraud and contribute to the reduction of poverty while also promoting sustainable national development. They are an important element of a nation's public financial management system, assuring parliaments, citizens, development partners, and others that governments are effectively managing their finances (OECD, 2010).

Government revenue and expenditure audits are the responsibility of supreme audit institutions, which are national-level watchdog institutions. They ensure that resources are spent in accordance with national government directives by closely examining public financial management and reporting (Transparency International, 2008).

However, audit institutions frequently operate in unstable democracies in developing nations where the judiciary and parliament are unable to hold the government accountable, undermining the independence of audit institutions. Furthermore, it is frequently difficult to complete the rigorous, high-quality audits required to ensure transparency, openness, and accountability in the administration of public finances due to a lack of resources and technical expertise (Mbaguta, 2020). Ethiopia is one of the world's emerging nations. "Poverty is made worse by corruption, which can be petty or grand and hinders progress."

Some of the factors that contribute to corruption flourishing in the nation include a lack of accountability and transparency, low levels of democratic culture and tradition, a lack of citizen participation, unclear regulations and authorization, a low level of institutional control, a lack of punitive measures, and the centralization of power and resources. In spite of the fact that anti-corruption laws remain strong in principle, they are not properly put into practice. The judiciary and legislature remain under the executive's control (Rahman, 2018).

2. LITERATURE REVIEW

2.1. The Concepts of public Sector and Public Sector Audit

Defining the public sector is difficult due to the complexity of the delineation. However, literature suggests that the public sector can be defined in terms of source of funding, ownership and control, direction or regulation, or the provision of social services (Danescu, 2011). In general, the public sector consists of governments and any publicly controlled or publicly funded entities, corporations and other entities that provide public programs, goods or services.

Traditionally, the independent external auditor's function has been to assure the legislature that the financial statements that the government has provided abide by relevant accounting standards. The legislature needs confirmation from a recognized professional organization that the administration hasn't "cooked the books." This assurance has expanded over time to also include assurance that the existing financial systems are in accordance with the standards. The external auditor is regarded as playing a crucial role in the accountability process in this function. Since it is an attested audit, the auditor's "report" is formally a part of the public accountability process between the government and the legislature and is included in the government's reporting to the legislature. It is also part of the official record (Mayne, 2006). The external auditor continues to provide the legislative assurance through performance audit. Instead than focusing on the government's financial records, it is important to consider how effectively and efficiently it is achieving its goals. Most reporting is straightforward, with the auditor's report being presented to the legislature and made available to the public. Since the reporting is required by law, it is an integral part of the accountability system. Compared to the financial attest job, the performance audit role for external auditors is a significantly more recent development.

There are types of audits in the public sector, namely financial audits (including compliance) and performance audits (Dwiputrianti, 2011). Compliance auditing refers to the traditional forms of an audit that next to financial auditing has been known since Ancient Egypt and China. The conception of state auditors independence and self-dependence was firmly established, the consolidation of legal provisions in public finances auditing was founded, and the basic institutional patterns of the public auditing were grounded, namely auditing chambers headed by the Auditor General (Yuliia & A, 2018). Performance auditing is defined as an impartial assessment of the economy and efficiency of auditee activities, as well as the efficacy of public-sector programs.

Public Sector Audit is conducted to protect public-owned resources by ensuring adequate accountability; upholding standards of conduct in the public service, and helping public services get value for money. The International Organization of Supreme Audit Institutions (INTOSAI) defines public sector auditing as an examination of the operations, activities, and systems of a given entity to verify that they are being carried out or functioning in accordance with specific goals, budgets, rules and requirements (Oyebisi, 2017). Because the public sector's ability to deliver services successfully and carry out programs in an equitable and appropriate manner is measured primarily by its ability to deliver services, public sector audit activities should have the authority and competency to evaluate financial and program compliance, effectiveness, economy, and efficiency. Auditors must also safeguard the public sector's basic principle, as it serves all citizens.

2.2 Theoretical Framework

2.2.1 Agency Theory

Agency theory has evolved along two paths since its origins in information economics: positivist and principal-agent. The contract between the principal and the agent is a common unit of analysis in both streams. They also have similar beliefs about people, organizations, and data. Their mathematical rigor, dependent variable, and style, on the other hand, differ (Eisenhard, 1989). Some scholars argue that the audit helped promote public sector accountability and emphasize that public sector audit is a key element in examining and evaluating government accountability for the use of public funds and the delivery of public services. Public sector audits can be an essential element in ensuring the efficiency, effectiveness and accountability of government to the public (Dwiputriant, 2011).

2.2.2 The Lending Credibility Theory

According to this theory, the major objective of the audit is to provide credibility to the financial statements. From this perspective, the service that the auditors are providing to their clients is reliability. Users of financial statements notice aspects in audited financial statements that give them more confidence in the data supplied by management (in the financial statement). Users are seen to gain from improved credibility, which is often thought to imply that the quality of investment decisions improves when they are based on accurate information (Ittonen, 2010).

3. EMPIRICAL LITERATURE REVIEW

A numbers of topics emerge from the literature review and history review. One of these is the fact that there are several complementary arguments for why auditing is beneficial. The importance of agency relationships in understanding the value of auditing is especially essential in the public sector, where these interactions are more intricate. Auditing has always been necessary for management control (Cordery, 2017). According to (Mebratu, 2015), a research Conducted on internal audit function and its challenges in public sector governance: Empirical evidence from Amhara National Regional State, Ethiopia using the Ordinary Least Squares multiple regression approach. The study found a link between the role of audit risk management and professional audit standards, formal mandates, unrestricted access, competent leadership, and management assistance and professional audit to be found. Even the world's most advanced countries will not be able to completely implement all of them. Research by (Yismaw, 2007) evaluated the effectiveness of internal audits in Ethiopia's public sector. According to the standards are among them. In several Sub-Saharan African countries, a few of these components can study; internal audit effectiveness was determined by organizational setting, audit quality, management support, and auditee characteristics. Internal audit quality and management support were shown to be the most important criteria for the internal audit function's performance, although organizational context and auditee characteristics were not. Despite the fact that internal audit plays a critical role in the performance of any business, institutional management does not respond adequately to the findings and suggestions of internal audit.

4. SAMPLING PROCEDURE AND SAMPLE SIZE DETERMINATION

The study used primary data from the office of the auditor general of Ethiopia; using a simple random selection method, respondents were selected from the auditing staffs. The Yamane (1967) formula was used to determine the sample size.

To provide an overview of the relationship between public sector auditing and public expenditure management in public sector entities, a descriptive analysis was used based on the results of a structural equation model.

This formula was used to calculate the sample sizes at 95% confidence level and P = 0.5 is assumed $n = N / [1 + N (e)^2]$

Where

n= is the sample size,

N= is the population size, and

e= is the level of precision/sampling error

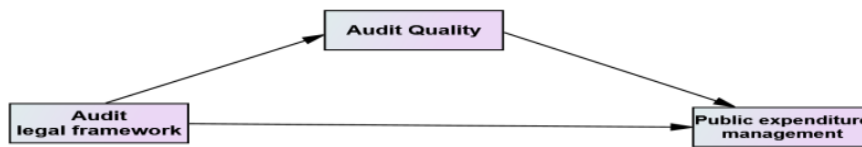
When this formula is applied to the above population, we get

$$n = N / [1 + N (e)^2]$$

$$n = 207 / [1 + 207(0.05)^2]$$

$$n = 136$$

Simple Mediation Model



Model: 4

Y: PEM

X: Legal

M: Audit-Quality

Sample

Size: 136

OUTCOME VARIABLE:

Audit-Quality

Table 1: Model Summary

R	R-sq	MSE	F	df1	df2	P
.3742	.1400	.0733	21.8173	1.0000	134.0000	.0000

Table 2: Model

	coeff	se	t	p	LLCI	ULCI
constant	2.9652	.1848	16.0479	.0000	2.5998	3.3307
Legal framework	.2358	.0505	4.6709	.0000	.1359	.3356

Standardized coefficient

Standardized coefficients
 Legal framework .3742

OUTCOME VARIABLE:
 PEM

Table 3: Model Summary

R	R-sq	MSE	F	df1	df2	p
.8356	.6983	.0129	153.8881	2.0000	133.0000	.0000

Table 4 Model

	coeff	se	T	p	LLCI	ULCI
constant	1.8476	.1326	13.9382	.0000	1.5854	2.1098
Legal	.3100	.0228	13.5709	.0000	.2649	.3552
Audit Quality	.1897	.0363	5.2320	.0000	.1180	.2614

Standardized coefficient

Standardized coefficients
 Legal .6970
 Audit Quality .2687

*****TOTAL, DIRECT, AND INDIRECT EFFECTS OF X ON Y *****

Table 5: Total effect of X on Y

Effect	se	t	P	LLCI	ULCI
.3548	.0232	15.3065	.0000	.3089	.4006

Table 6: Direct effect of X on Y

Effect	se	t	P	LLCI	ULCI
.3100	.0228	13.5709	.0000	.2649	.3552

Table 7: Indirect effect(s) of X on Y:

	Effect	BootSE	BootLLCI	BootULCI
Audit Quality	.0448	.0135	.0212	.0738

5. RESULT AND DISCUSSION

The researcher wants to know if a suggested mediator, M, can actually explain the impact of X on Y. Estimating the indirect effect through the mediator M is used to answer this question (Hayes 2013). The study assessed the mediating role of Audit quality on the relationships between Audit legal framework and Public expenditure management. The result revealed a significant indirect effect of audit legal framework on public expenditure management (0.0448, $t=13.5709$), Supporting H1. Furthermore, the direct effect of audit legal framework on public expenditure management in the presence of the mediator was also found significant ($b=.3100$, $p<0.001$). Hence, Audit quality partially mediated the relationship between audit legal framework and public expenditure management. It is a complementary mediation rather than a competitive mediation since both direct and indirect effects have the same positive coefficients.

Table 8: Mediation analysis

Relationship	Total Effect	Direct Effect	Indirect Effect	Confidence Interval		t-Statistics	Conclusion
				Lower Bound	Upper Bound		
Audit legal framework->Audit quality->Public expenditure management	.3548	.3100	.0448	.0212	.0738	13.5709	Partial Mediation

6. ONCLUSION AND RECOMMENDATION

6.1 Conclusion

The study discovered that the higher the audit quality of the auditor general, the better the public expenditure management in public-sector entities. Even if there are different factors that affect the efficiency and effectiveness of government expenditure management, the legal framework of audit institutions has a significant influence on the parties who are involved in the public expenditure management aspects of government activities by creating a deterrent effect to work in line with legal frameworks. Furthermore, if the audit legal frameworks are clear and unambiguous, it reduces conflict between the auditee and the auditor of the audit institution.

6.2 Recommendation

- ❖ The government should allocate adequate resources to improve audit institutions in order to fulfill its responsibility to ensure that public-sector organizations fulfill their intended purpose without resource waste, misappropriation, or corruption.

- ❖ The legislative and judicial organs of the government should actively work to ensure the legal frameworks of the audit are properly implemented as per their intended purpose.
- ❖ The audit institution's legal department should review the audit legal frameworks (legislation, regulations, directives, and manuals) on a regular basis and provide feedback to the appropriate body for amendments.
- ❖ The auditor general's office should provide intensive training to its auditors on audit legal frameworks so that they are familiar with them and can apply them.
- ❖ The auditing institution should collaborate with stakeholders to gather feedback on legal loopholes and make immediate corrections.

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