

## FACTOR-FACTOR THAT INFLUENCING INDEPENDENCE OF PUBLIC-SECTOR AUDITOR: A LITERATURE REVIEW

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### Abstract

The study of public sector audit is a relatively large, complex, unexplored and under-recognized field. Therefore, researchers call for more studies on public sector audit, especially in the context of developing countries. This article gives review of academic study pertaining to public-sector auditors' independence and factors affecting public-sector auditors' independence. This literature review is implemented based on published papers in 20th century in prestigious journals related to public sector audit. Firstly, we review and explain definition of independence clearly. Secondly, we organize our review around three main threats to public-sector auditors' independence, namely, (a) political manifestos, (b) auditor tenure, and (c) relationship with auditee. For each of the threats, this study discusses the effects of each threat on the public-sector auditors' independence. Additionally, we conclude that proofs together with recent changes, provides for future study on public-sector auditor's independence.

**Keywords:** Auditing, Public sector, Auditor, Independence, Supreme Audit Institution

### 1. Introduction

There is the long history in public sector audit, the public sector audit organizations have been developed in the world since the 1980s. The origin is related to a number of issues that have been identified social interest such as the resurgence of audit society (Power,

1997), the development of public sector audit as part of new public management reform in countries such as Australia , New Zealand, Canada, USA, UK, Netherlands and Nordic countries (Barzelay, 1997; Parker, Jacobs, & Schmitz, 2019; Pollitt et al., 1999). Public sector audit is carried out by the

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Supreme Audit Institution (SAI) in each country, whose primary role is to audit and other assurance services to enhance the accountability of government (Salih<sup>1</sup> & Hla, 2015). SAI is important in ensuring that an unbroken chain of accountability exists between Congress and the Government (Funnell, 1994), in which SAIs' auditor is the individual who implements the audit activity within SAI. On the one hand, public sector audit contributes in enhancing government accountability and public sector transparency (Clark, De Martinis, & Krambia-Kapardis, 2007). In addition, audit quality in public sector plays a potentially crucial role in preventing corruption along with the long-term development of democracies and social welfare (Gustavson & Sundström, 2016; Johnsen, 2019). However, experience practically shows audit is not highly effective in fight against corruption (Jeppesen, 2019) or ethical (Bringselius & Management, 2018).

International Organization of Supreme Audit Institutions (INTOSAI, 1998) has issued a statement about independence in audit, the core principle

commonly recognized by Supreme Audit Institutions as an essential requirement of public sector audit. The focus on independence heralded a future academic study. Currently, independence is evaluated essential to modern auditing practices, regardless of economic field of audited organization operates (Wanna, 2006). Available literature offers little proof of social position and public-sector auditors' independence (V. S. Radcliffe, 2008, 2011; Smyth & Whitfield, 2017). There is a general view that state auditors are independent of the political and policy world, constrained by law and practice to focus on financial and performance audit rather than policy objectives (Funnell, 2011). This view of independence of public-sector auditor is deeply ingrained in the research literature, as Normanton and Normanton (1966) argue that state auditors are perhaps the best defense of citizens against abuses using money taken from people's pockets. Research literature shows that although the independence of private sector auditor has been much discussed in the past three decades,

there are few studies on reducing independence in public sector (Gendron, Cooper, & Townley, 2001; Hay & Cordery, 2018; Tepalagul & Lin, 2015). In summary, studies on factors affecting public-sector auditors' independence in countries are still few and need to be supplemented with more empirical evidence. This paper shows factors affecting public-sector auditors' independence, followed by a review of the historical development of public sector auditing.

## **2. Literature Review**

This research is a conceptual research that uses literature research methods sourced from authoritative journals and documents and is still relevant to the study of auditors' independence in public sector and public sector audit in contemporary society.

## **3. Results and Discussions**

### **3.1. Public-sector auditors' independence**

According to (Mautz, 1961), independence is a difficult understandable conception. According

to Gendron et al. (2001), independence is a social construct in which statements about auditors' independence are socially guaranteed. Furthermore, auditors' independence is a difficult understandable conception because it is an expression of professional integrity (Carey & Doherty, 1966). Therefore, independence is a concept which there are no proper definition and different practices, expressions and interpretations that the auditor considers appropriate to maintain value of audit and objectivity. Auditors' independence is drawn from a variety of sources, including auditing and corporate law, professional codes, auditing practices, education about citizenship and democracies' functioning. In public sector audit or government audit, public-sector auditors are responsible for protecting public resources, tax revenues contributed by citizens and the government from abuse and ineffective use (Normanton & Normanton, 1966). Public-sector auditors' independence is important because auditors are required to be able to critique government work and make public reports objectively

(Normanton & Normanton, 1966). The importance of audit working and reporting requires public-sector auditors to have a high degree of objectivity and integrity because they highly have responsibility to hold government accountable for the management of resources and public finance. Therefore, the level of requirements for the independence of public finance is particularly high. There are features of auditors' independence, which are similar to between private sector and public sector, typically terms such as independence of thought and independence of form are recognized in both areas of audit. (GAO, 2011). It is argued that in the first place in independence is the attitude and mind of auditor and should be inculcated in the mind of the auditor (Mednick, 1990), the auditors' personality is the point of beginning to help the auditor be objective and fair. Next, the auditor's independence has two aspects: independence from the practitioner himself and independence from the profession widely known as independence of thought and

independence of form (Mautz, 1961), is accepted in many academic studies and is common in contemporary auditing literature. Accordingly (i) ideological independence is the ability of auditors to carry out their work with integrity, objectivity and professional skepticism; (ii) formal independence is the avoidance of any situation that might lead a third party to conclude that an auditor has lost their professional skepticism, objectivity and integrity (Porter, Simon, & Hatherly, 2014). In addition, there are different views on the dual dimensions of auditor independence, such as operational and organizational aspects (Power, 1997), and human and organizational factors. (Flint, 1988). The role of organizational arrangements includes reasons for appointing auditors and a clear mandate for auditors to carry out their duties (Flint, 1988). The principle of independence in public sector audit has a point to note that auditors and SAI must not be dependent on the executive authority, must be independent from the executive authority (Normanton & Normanton, 1966) because the

responsibility of the auditors is to audit accounting of public resources and finances managed and operated by units of the executive branch. The basic issues that need to be done in maintaining the independence of the public-sector auditor include issues related to the rights and obligations stipulated in the constitution, the law on the authority, appointment and dismissal of the public-sector auditor, on access to information, independently issue audit reports and have adequate supplies to perform the audit duties (INTOSAI, 2007).

The auditors' independence is crucial both private sector and public sector in order to ensuring audit legitimacy and quality (Francis, 2004). According to Tepalagul and Lin (2015), auditors' independence affects audit result as well as is one of predictors of audit quality. Lack of auditors' independence has resulted in poor handling of financial issues and low audit quality (Chen, Hsu, Huang, Yang, & Research, 2013). Lack of independence not only corrodes the

reputation of the profession but also has many unpredictable financial and non-financial consequences and reports with irregularities, damaging audit quality. Furthermore, Power (1997) argues that auditors' professional competence is less important than their independence. Additionally, public-sector auditors' independence is studied mainly in Western countries with developed democracies. Therefore, public-sector auditors' independence has always become a matter of concern for many researchers and has not been studied in many developing countries. One of the most discussed issues in audit literatures is independence (2015). Independence is considered a cornerstone of auditing practice (Mautz, 1961) because it builds the confidence of users of audit result (Carey & Doherty, 1966). Independence's important role is explained as building the value of audit implementation and results (Flint, 1988), without independence, the audit work is practically not valuable (Power, 1997). Therefore, the study of auditor independence is one of main issues in academic study on auditing.

Researching on independence has parts including searching for definitions of independence, the importance of audit independence and factors affecting auditor independence.

### **3.2. Factors influencing the independence of public-sector auditor**

#### **3.2.1. Political manifestos**

In the public sector, public-sector auditors' independence is essential to enable them to be impartial and fearless in assessing public management and releasing reports to public (Normanton & Normanton, 1966), so that related parties can use audit reports as a tool for making decisions. Therefore, role of public-sector auditor requires greater independence in terms of social significance as public interest in public services is generated (Flint, 1988). One of basic principles is embodied in Lima Declaration (adopted at the 9th INTOSAI Congress, 1977 in Lima, Peru): *“The independence of the Supreme Audit Institution could not be separated from employees' independence. Employees here are*

*understood as: those who must make decisions on behalf of the Supreme Audit Institution and are responsible for the third parties; members of the decision-making body or the head of the Supreme Audit Institution ”* (INTOSAI, 1977). Moreover, academic research show that auditor independence is closely related to SAI's independence. For example, Funnell (1994) in the United Kingdom, found out that public-sector auditor's independence is practically not feasible because the nature of SAI is affected by the domination of expenditure budget from the executive. Therefore, public-sector auditor must comply with government interests. Similarly, the research of Xiao, Yang, Zhang, and Firth (2016) at SAI China, indicated that dependence on the executive makes the organization of SAI's operations less effective and will not improve public sector budget. Therefore, SAI must have sufficient human and financial supplies and executive body should not control supplies (INTOSAI, 2007). However, operating budget of SAI is supported from state budget, so if SAI does not

have spending fund, it leads to serious problems in their tasks and functions (Fiedler, 2004). Thus, SAI can propose its own budget but also involve the executive and the legislative bodies in approving fund. According to research by Normanton and Normanton (1966), public-sector auditors are able to the right to freely access documents, information, data or any other official information source of the audited entity because otherwise this, their work will be less than worth. ISSAI also recommends that SAI have unrestricted access to auditee's information as it is essential to carry out SAI's legal duties (INTOSAI, 2007). However, legislative body do not want to allow public-sector auditor to access information that public-sector auditor needs to exploit and this could have a serious effect on public-sector auditors' independence as well as audit result (Bowerman, Humphrey, & Owen, 2003). Above overview of these issues shows that the independence of public auditors depends on the political institutional arrangement, with the focus on aspects of SAI's independence rather than on individual

aspects of public-sector auditors, specifically aspect of organizational SAI based on constitutional mandate and statutory protections of SAI's role, SAI's duties and powers, ability to access information, SAI's expenditure budget and human resources (Goolsarran, 2007). Furthermore, other studies have also pointed out a number of factors affecting public-sector auditor's independence including mechanisms management control, reporting requirements and compliance, along with changing political statements and policy priorities (Gendron et al., 2001; Hay & Cordery, 2018; Johnsen, 2019; V. S. J. A. Radcliffe & Interest, 2012). Research on how political leadership affects public-sector auditors' independence has been mostly studied in developed democracies such as Denmark (Skærbæk, 2009), Canada (V. S. Radcliffe, 2011), Australia (Funnell, 2015), Germany, Italy (Monfardini & Maravic, 2012) and the United States (V. S. J. A. Radcliffe & Interest, 2012). Researching on political leadership affecting public-sector auditors' independence in developing countries is

rather limited. The most typical is the study of Sumiyana, Hendrian, Jayasinghe, and Wijethilaka (2021) in Indonesia, drawing on Gramsci's theory of hegemony to test political leadership and political ideology that affect public-sector auditors' independence in Indonesia through ruling class psychology, imperium, sphere of influence and ideology. Through document analysis and in-depth interviews conducted with staff, supervisors and professional investigators at SAI Indonesia, it was found that ideology and political leadership influence auditors' perceptions. Contrary to the widely accepted idea in developed democracies that the independence of public-sector auditors is guaranteed by the legislature (Morin, 2014), the results of this study argued that the active intervention of political leadership reduces the public-sector auditors' independence and leads to decrease audit quality. However, the results of the study in Indonesia are in agreement with the study of Isaksson and Bigsten (2012) in developing countries, where SAIs do not operate

independently, even though SAI is established by the legislature and operates independently. At the same time, the study also argues that the impact of the ruling political institution, forcing public-sector auditors comply with the political policies, makes public-sector auditors' independence faces many pressures, difficulties and decline. Ultimately, this study enhanced understanding of how political rights, aided by coercion, ruling-class psychology and spheres of influence, significantly erode the constitutive role of auditors, increasing public concern about value for money as well as effectiveness and efficiency of the public sector. Besides, the research literature also gives very little evidence of the social position and independence of public auditors (V. S. Radcliffe, 2008, 2011; Smyth & Whitfield, 2017). Recently, a number of studies have questioned the extent to which the audit findings and audit opinions of public-sector auditors are really independent of political statements and agendas (Funnell, 2011; V. S. Radcliffe, 2011). According to V. S. Radcliffe (2011), "it



*is not good to think that public-sector auditors have been independent of politics and policy. Instead, auditors work within discrete frameworks of what can be done in more nuanced and practical ways”* Funnell’s (2011) study in favor of public-sector auditors’ independence emphasized that *“The independence of public- sector auditors mean to ensure that they will be able to protect and enhance the public interest, is the means by which the legislature as a public representative is provided with means to hold the head accountable”*. Research results of Funnell (2015) show that after debate, Australian Government acknowledges that work and reputation of SAI in auditing activities is a strong mechanism in strengthening the political institutions for political background. Research by L. M. English (2007) based on case study evidence from Australian public-private partnership audits, the research results suggest that system-based pre-contracting audits are more likely to ability to legitimize government political activities rather than ensure independent oversight.

The results of a study argue that SAI must adopt policies adopted by auditors of private-sector such as auditors’ mandatory rotation to audit different auditees to enhance auditor’s independence. This comes from performance audit, because performance audit requires auditors work closely with government to make recommendations on improving effectiveness of government programs and institutions (Gendron et al., 2001). This is argued by Skærbæk (2009) that the ability of public-sector auditor will take on advisory role to the implementation of the process and change the way of management in public management programs and contents of the government to achieve the goals efficiently. Therefore, researching suggests that involvement of public-sector auditors in improving government activities has risk of undermining public-sector auditor’s independence as they will be involved in government activities, providing consulting and recommendations. However, performance audit is one of three types of audit that SAIs must audit

public sector in each country in order to perform legal functions and duties. Therefore, applying the mandatory rotation policy to public-sector auditor to audit different entities can be limited to the mentioned existence.

In additionally, the political leadership's scale was developed by Sumiyana et al. (2021) based on Gramsci framework and public sector audit's process in Indonesia, studied in the context of influence of political hegemony and ideology on auditors' independence at SAI Indonesia. The scale of political leadership is inherited by the author from the study of Sumiyana et al (2020). Accordingly, political leadership is mentioned in four aspects including: (i) supreme power (imperium or supreme power), that is, political ideas are promoted by political states or units, regions. government established by state policies, regulations and procedures; (ii) ruling-class psychology, that is, the stratification and classification of financial capital into social groups based on education, personal power, wealth and social

relationships is very common; (iii) sphere of influence, that is, the influence of politics is established on the beliefs, attitudes and behaviors of individual auditors in particular and SAI in general; (iv) ideology of performativity, that is, persuading others to engage in behavior by dominating group behavior.

### 3.2.2. Auditor tenure

Auditor tenure is the number of consecutive years that an auditor audits an auditee (Ellis, Booker, & Accountancy, 2011; Ghosh & Moon, 2005; Gul, Jaggi, Krishnan, & Theory, 2007; Lowensohn, Johnson, Elder, & Davies, 2007). Due to the limitation of academic research on auditor tenure in public sector, author borrowed previous research papers in private sector audit to review the relationship between auditor's tenure and independence. This argument is considered appropriate by the author because the concept of auditor's tenure is uniformly defined by scholars. Studies on auditor's tenure in the private sector are divided into two opposing views. The first point of view is that auditor audit for a client so much,

the closer the relationship with auditee, as a result, auditor may make biased judgments for auditee. For example, study by Donald R. Deis and Gary (1992) suggest that the longer auditor tenure has negative effect on auditor independence. The researchers found that longer audit tenure negatively affects auditor independence because auditors become more accounting regulations easily such as increasing accrual accounting. Using quantitative approach, Donald R. Deis and Gary (1992) suggested that decline in audit quality is related to opportunistic behavior or complacency. Studies imply that long-term auditor tends to lead to the auditor's carelessness, omission of auditee or inappropriate making-decision in preparation of financial statements. Scholars argue that short-term auditor, of two or three years, makes lower quality of financial statements Johnson, Khurana, and Reynolds (2002). In some countries, there is a requirement of auditor tenure to maintain auditor independence as a way of mitigating the familiar threat that could impair professional judgment as

well as auditor skepticism (Fearnley, Beattie, & Brandt, 2005). The second point of view, no significant evidence has been found that the longer auditor tenure has a negative effect on auditor independence (Carcello, Nagy, & theory, 2004; Knechel, Vanstraelen, & theory, 2007; Myers, Myers, & Omer, 2003). Typically, the study of Myers et al. (2003) suggests that the longer auditor's tenure, even encourages auditor to take greater restrictions on negative management decisions, reducing risk of errors in the financial statements. Although there is evidence that the auditor tenure may not adversely affect the auditor independence, precautions continue to be taken. Therefore, the longer auditor tenure is still considered to pose a threat of familiarity for auditor.

Studies measure auditor tenure using a dummy variable, by calculating a quarter of the tenure cycle (tenure  $\leq$  2 years, tenure  $\leq$  4 years and tenure  $\geq$  6 years). Other studies use auditor tenure in different countries to measure such as the United States and some European Union countries, which determine the

auditor tenure (Vanstraelen, 2000) by specifying minimum and maximum time. Accordingly, some studies have used the above provision as a reference to determine short, medium and long term (Carcello et al., 2004; Gunny, Krishnan, & Zhang, 2007) or simply a way of determining the minimum period of time after which the entity and the auditor can terminate their relationship (Knechel et al., 2007). The study of Fitzgerald et al. (2012), which classifies auditor tenure into 3 short-term groups (from 1 to 2 years), medium (from 3 to 5 years) and long term (over 6 years).

### **3.2.3. The relationship with auditee**

Studies on the impact of relationship with auditee mainly in private sector audit. The results of many studies suggest that the risk of high familiarity with auditee has a negative impact and impair auditor independence (Quick & Warming-Rasmussen, 2015). A typical study by Lennox (2005) suggests that senior personnel of auditee who used to be audit director or a member of the audit team are susceptible to threats of intimidation or

threats from familiarity with their work, impair auditor's independence. Some views from other research results suggest that this relationship does not affect the auditor independence (Mautz, 1961). In public sector auditing, auditees are mainly public agencies and organizations belonging to executive agency or state enterprises. Therefore, examining the issues surrounding public-sector auditor independence with the executive body has been the focus of relatively recent studies. During the 1990s, studies tended to focus on the true meaning of such independence in practice (Barrett, 1996; Funnell, 1994; Parker & Guthrie, 1993), perhaps as a result of poor governance in Australia, especially during the 1980s. First, the relationship between the head of SAI, commonly known as Auditor General, also known as SAI's senior auditors, and executive body are interested by many researchers. For example, many calls to strengthen the authority and independence of Australia Auditor General have been made at very high levels through investigations by various parliamentary committees and even

Royal Commission of Australia (Kennedy, Wilson, & Brinsden, 1992). These requests have been addressed in regional jurisdictions of Australia under new and detailed regulations. The comparison of different supporting regulatory frameworks provides a rich source of data for researchers interested in issues of government accountability. For example, De Martinis and Clark (2003) compare the powers authorized by Australia Auditor General to highlight the extent to which legislation provides the foundation needed to maintain public sector accountability and support public sector accountability and support prerequisites related to independence, mandate and funding. Besides, the study of Coghill (2004) on the relationship of Auditor General with Parliament of the Commonwealth of Australia and the Australian Territory Legislative Assembly (Australian Capital Territory Legislative Assembly), found that SAI Australia operates in a governance environment in which there are linkages, interdependencies and interactions, so the independence of the public audit is seriously affected, which

are the main factors affecting to the audit results. Thus, the Standard on Public Sector Commissioners (2006) identifies and details existing legislative mechanisms to strengthen the independence of six congressional accountable public servants. Australia, including Auditor General. Research by Pearson (2009) and Robertson (2009, 2013) compared the regulatory frameworks for Auditor General in Australia and New Zealand, finding that more can be done to protect public-sector independence and Auditor General from undue influence of the executive government.

The Auditor General's long-term role in helping to ensure open and accountable government as well as the impact of entities, public organizations or politicians on Auditor General. According to Van Zyl, Ramkumar, and De Renzio (2009), who reviewed the results of a survey of government budget transparency in 85 countries and found that 80% did not provide enough information to hold accountable government and 50% provide so

minimal information that they can hide information that is not disseminated, causing waste and corrupt spending. However, there are still tensions and conflicts between the SAI and the executive government. In 1997, Victorian Prime Minister (Mr. Jeff Kennett) tried to dissolve State Audit Office and privatize it, but the results were unsuccessful. This policy decision was a major issue in the September 1999 Victorian election and is now considered a major factor in the defeat of the Kennett government (L. English, 2003; Funnell, 1996, 1997; Good, 2007; Wanna, 2006). The conflicts of the late 20th century between the independence of public sector audits and the accountability of the executive government due to the NPM reform, generated discussion about the importance of the relationship of independence between the Auditor General, the State Auditor General and parliament in governance systems (Coghill, 2004; Parker & Guthrie, 1993).

The relationship with the audited entity is the auditors' understanding of

auditee (individuals, organizations) according to consistency (Herda and Lavelle, 2012). Research results of Bamber & Iyer (2007) on the auditor's relationship with auditee that threatens the auditors' independence, using the Organizational Identification scale (Mael and Ashforth, 1992; Wan-Higgins et al., 1998) career orientation to measure occupational identity, to measure the relationship with auditee. Many later audit studies inherit the measurement scale according to Bamber and Iyer (2007) to test in different country contexts (Bauer, 2015; Stefaniak et al., 2012; Svanberg and Öhman, 2015).

#### **4. Conclusion**

Reviewing above research papers, the author believes that three factors affecting auditor independence mainly include political leadership, auditor tenure and the relationship with auditee. These factors are also included in the issues described by ISSAI with a similar interpretation of public-sector auditors' independence in the eight core principles of independence of public

sector audit organizations (INTOSAI, 2007). These eight core principles include the legal framework (constitutional, statutory); appointment and term of office of auditors; wide implementation tasks; unrestricted access to information; the right and obligation to report on the work of the auditor; the freedom to decide the content and timing of the audit report; the existence of financial autonomy and assurance mechanisms (INTOSAI, 2007). Additionally, this paper also summarizes and recommends scales in order to three factors affecting auditor independence. According to author's reviewing, factors affecting public-sector auditors' independence have not studied in quantitative method yet. So, a quantitative survey needs to be warranted in this regard.

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