

INSTITUTIONAL PERSPECTIVES OF EXTERNAL PUBLIC AUDIT

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Abstract

Institutional arrangements (as a synergy of formal and informal institutions) can decisively contribute to mitigating slippages related to the effective functioning of the intrinsic mechanisms resulting from the manifestation of the principal-agent binomial. Some externalities generated by the functioning of bureaucratic organizations tend to vitiate the mandate offered by the citizen to the governmental level, as a representative of the fundamental interests of the population. Starting from the institutionalist paradigm and tools (formal and informal institutions, the imposition of contracts, transaction costs), our research aims to analyze, using a qualitative approach, the role of external public audit in the functioning of formal and informal institutions, in relation to public organizations. The main results of the study highlight the way in which the external public audit carried out by the Supreme Audit Institutions (SAIs) contributes to remedying the deficiencies related to the improper promotion of taxpayers' interests, the fading of moral hazard (through the prism of opportunistic behavior) as well as the creation of premises aimed at increase trust in society.

Key words: agency theory; institutions; external public audit.

The level of economic and social development of a country cannot be explained without recourse to the (neo)institutionalist paradigm and tools, in which the formal institutions (the legal system – property rights, the judicial system that ensures their enforcement) and the informal ones (social norms, values, trust, culture, trust) coexist and create a dynamic framework designed to structure human behavior through the constraints generated in the social, economic, legal plane (North, 1990). While the imposition of the first category is carried out through the state, the second category represents the prerogative of society as a whole, in the sense that the violation of some values, customs can be sanctioned by exclusion, loss of membership, etc. In fact, institutions represent the rule of the game, while organizations represent the actors.

The coexistence of the two fundamental types of institutions should not be viewed from a static perspective, they make up institutional arrangements that evolve according to a variable geometry, in which some formal institutions can be replaced by informal ones, the reciprocal being fully true. Moreover, although interdependent, they can come into contradiction when, for example, an import of a legal institution, is not grafted on traditional social values, that institution becoming inoperable de facto.

While some formal institutions can be changed by legislative will, informal ones are quasi-immutable, the change occurs incrementally, given that they represent social norms, validated over long periods of time (Pejovich S., 1999).

Although these institutional frameworks mark human actions in each country, opportunistic behaviors appear that generate additional transaction costs, loss of trust between economic actors, compression of commercial exchanges (Williamson C.R., 2009).

The conflictual relationships (imprinted by opportunistic behavior) that appear within the principal-agent binomial (agency theory) represent an eloquent example (Jensen M.C., Meckling W., 1976). Thus, benefiting from the advantage of informational asymmetry, the agent (manager) who acts in the name and on behalf of the owner (shareholder), of the one who owns the property of the assets, has the inclination to internalize part of the rent owed to the owners. In this situation, monitoring costs become incidental, the principal having two options – either to grant (additional) incentives to the agent, in direct relation to the achieved production, or to appeal to the audit.

Although that theory finds its vein in the private sector, it is also confirmed for the public sector, but a little nuanced. Thus, at a first level, the electorate (the citizen having the capacity of principal) empowers the legislature (agent) by

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voting to promote their own socio-economic interests. In turn, the legislature becomes an agent through the mandate given to the executive, which in turn grants mandates to government agencies (the lower hierarchical level).

The asymmetry of information and the temptation to appropriate rents (state capture) can propagate exponentially from the first to the third, level, generating institutional alteration, high monitoring and transaction costs, decreasing trust.

MATERIAL AND METHOD

In this context, our approach aims to analyze how the external public audit carried out by the Supreme Audit Institutions (SAIs) contributes to remedying deficiencies related to the improper promotion of taxpayers' interests, blurring moral hazard as an expression of opportunistic behavior, as well as creating the premises aimed at increasing trust in society. The announced objective calls for a qualitative approach and represents an original own contribution, intended to integrate agency theory into institutional arrangements at the level of the public sector.

RESULTS AND DISCUSSIONS

Agency theory projected at the level of the public sector opens certain perspectives worthy of investigation. At the first level, citizens feel the need to be informed about the decisions adopted by the elected and whether they are not in disagreement with the electoral promises before the election. The existence of gaps between the proposed objectives and the present reality will contribute to the sanctioning of this category of agents in the future.

At the same time, the legislature finds itself in a position to appreciate how the mandate offered by it to the government actually materializes. A possible non-compliance of those empowered in this regard will lead to the decrease of voters' confidence in the legislature's ability to concretely implement the adopted strategies.

For its part, the government is aware that if its own organizations (government agencies) act in dissonance with the programs/operational plans drawn up, it will have to provide additional explanations to those who have invested it.

Moreover, even if the proposed objectives have been achieved, the level of financial resources engaged matters both for the electorate and for each of those who hold the dual quality of principal and agent.

From this perspective, evaluating the costs involved/related to the results obtained is not a very easy approach, as the public sector does not

operate according to the same rules as the private sector. For each of these actors, agency costs increase, any slip-ups will be hard on the citizens. Even if various internal control systems are designed at the level of these levels, their architecture may leave something to be desired or the operation may be flawed by the lack of effective independence (Mueller D., 2003).

Things get even more complicated if we also take into account the competitive political pressure existing in multi-party systems – the opposition will undoubtedly charge any error, waste or gap with the political promises of the electoral campaign through the mass media (Baber W.R., 1983).

In the presented context, against the background of the legacy of fragile informal institutions (path-dependence), benefiting from information asymmetry (which transposes very high agency costs for citizens), moral hazard will materialize, in the case of some public actors, in opportunistic behaviors, appropriation of rents or mystification of the results obtained and the resources allocated. As a consequence, the legal institutions that ensure low transaction costs (predictability and operability of the law) will be affected, and economic exchanges defused (Sung J., 2005).

Factual records and contributions from specialized literature converge towards the idea that the existence of objective, independent, professional, responsible, efficient supreme audit institutions, through the specific activities carried out (financial, compliance, performance audit) contributes to the decrease of agency costs, the fading moral hazard, promoting trust, transparency and accountability (Intosai 2013a; Intosai, 2013b; Lai S.M., Liu C.L., 2018; Corten *et al.*, 2017). The promotion of trust is manifested at the level of each principal-agent category, by virtue of the independence of the external public audit, especially considering that the supreme audit institution is an organization invested with public power, but also "owner" of national resources (Badamdorj B., 2010). There are situations in which during election years the demand of public law organizations for auditing increases, for reasons that involve certification, discharge or confirmation of performance (Kim S., 2014).

At the same time, responding to various social requirements, the external public audit shows flexibility, carrying out compliance audits aimed at combating fraud, corruption, in order to later, given the removal of these risks, direct its resources to activities that involve complex analyzes of the activity of the principals, from the perspective of compliance with the criteria of

efficiency, economy and effectiveness in the management of public funds (Walker, 2007).

We underline one of the basic requirements of the valorization of the external public audit, the communication/publication (an accentuated trend since the 1990s) of the results of the missions carried out, an important aspect both for the principal to whom symmetrical, credible and reassuring information is thus guaranteed, but also for the agent, structuring future behaviors and formulating recommendations to improve the activity (Gonzales, Lopez, and Garcia 2008).

SAI's direct communication channels provide information that is more reliable and true to reality, compared to the mass media, the latter seeking the sensational, or manipulating the information obtained. Communication with civil society remains defining for the implementation of the recommendations of SAI reports (social pressure) in the conditions where bureaucratic systems can significantly diminish the desired result of the formulated recommendations (World Bank, 2005).

Ex-ante audits and during budget execution can have a higher impact on public opinion than ex-post audits that refer to past budget exercises, however, the objectives of the mission or the audited field also count.

But the communication and involvement of civil society is not only one-way, from the SAI to the citizen, but there are organizations of this type (USA, Mexico, South Korea) that collect information from citizens regarding future auditable areas, petitions, reports of fraud, within well-designed information networks (UN DESA, 2013).

For public management, the information provided by SAIs after conducting audit missions become useful elements in adjusting sector strategies, reconfiguring the architecture of internal control systems, optimizing future decisions adopted.

Some authors show that the external public audit plays an active role not only in minimizing the loss of resources from the public sector, but also in the recovery process of possible damages, provided that there are legal powers in this regard and collaboration with specialized organizations (Chow, 1982).

Last but not least, as a result of the external public audit missions carried out, the SAI can formulate *de lege ferenda* proposals, aimed at modernizing the existing legal institutions, adapting them better to the socio-economic context.

CONCLUSIONS

Although formal and informal institutions coexist and make up institutional arrangements that evolve by marking human actions in each country, opportunistic behaviors appear that generate additional transaction costs, loss of trust between economic actors, compression of commercial exchanges, conflicting relationships that appear within the main - agent binomial (agency theory) is an eloquent example.

Benefiting from the advantage of informational asymmetry, the agent has the inclination to internalize part of the rent owed to the owners, thus becoming incidental monitoring costs.

The asymmetry of information and the temptation to appropriate rents can propagate exponentially from the first to the third, level, generating institutional alteration, high monitoring and transaction costs, decreasing trust.

The existence of objective, independent, professional, responsible, efficient supreme audit institutions, through the specific activities carried out, contributes to the decrease of agency costs, the fading of moral hazard, the promotion of trust).

The promotion of trust (informal institution) is manifested at the level of each principal-agent category, by virtue of the independence and professionalism of the external public audit.

The external public audit shows flexibility, through the activities carried out, but the communication/publication of the results of the missions carried out, guarantees the principal a symmetrical, credible, reassuring information.

For public management, the information provided by SAI following the audit missions become useful elements in adjusting sector strategies, reconfiguring the architecture of internal control systems, but external public audit also plays an active role in minimizing the loss of resources in the public sector, in the recovery process of possible damages and in the adjustments transposed in the legal-normative plan, contributing to the modernization of the existing legal institutions.

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