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Ph.D. Dissertation

The Effectiveness of Internal Control in Tackling Corruption

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University of Sussex

2016

Statement

I hereby declare that this thesis has not been and will not be, submitted in whole or in part to any other University for the award of any other degree.

Signature:

Summary

Historically, there has been a great deal of theoretical debate on anti-corruption mechanisms, but little in the way of detailed empirical research, especially at the organisational level (Monteduro, Hinna, & Moi, 2016). Research on accounting internal controls, understood as a set of management tools that are designed to provide reasonable assurance regarding the accomplishments of an organisation's objectives, including prevention and detection of corruption, is no exception to this as their usefulness and efficiency have been disputed (e.g. Neu, Everett, & Rahaman, 2015; Sikka & Lehman, 2015). As there has been very limited research in this area, this study systematically and empirically examines the effectiveness of internal control in tackling corruption in government organisations. The thesis adopts a qualitative approach using two government funds as cases. The 'most similar systems' design approach is employed.

The research concludes that the extent to which internal control is effective in tackling corruption depends on how the internal controls are initiated and enforced. As shown in the first case study, establishing an institution with a culture which implies that ethical behaviour is the norm increases the likelihood that particular types of anti-corruption controls will be effective. However, the second case shows that if the culture of the organisation appears to tolerate corruption, then the same mechanisms are unlikely to be as effective, leading to higher levels of corruption than in an organisation in which such practices are considered less acceptable.

In terms of theory, the thesis makes a distinctive contribution to the corruption literature by showing that the degree of successful implementation of anti-corruption measures guided by the principal-agent model depends on the quality of a clean, active, and powerful principal. Furthermore, the research demonstrates how theoretical triangulation can be a very powerful tool in understanding the nature of corruption, as alternative corruption theories can be complementary to each other and offer not only different diagnostics of corruption, but also different solutions.

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I. Introduction

Corruption is a socially, politically and economically complex phenomenon that produces a variety of outcomes and has a wide range of effects. Several studies have produced evidence to illustrate that corruption leads to reduced investment incentives (Mauro, 1995), decreased economic growth (Assiotis & Sylwester, 2014), lower quality of public infrastructure, decreased government revenue (Tanzi & Davoodi, 1998), reduced public trust in political systems (Seligson, 2002), the undermining of state legitimacy, and economic inefficiency (Rose-Ackerman, 1997).

According to Kofi Annan, former Secretary-General of the United Nations, corruption is an "evil phenomenon" that undermines the culture of democracy, slows economic development, and contributes to violations of human rights (The United Nations Convention against Corruption, 2004, p. iii). It also acts as a regressive tax, and erodes the quality of public services. Through corruption, wealthy people drain public funds that would otherwise be used to support social welfare programs (Kim, 2013). The World Economic Forum (2009) estimates annual bribes of one trillion dollars are paid and that corruption costs \$2.6 trillion per year, making it equivalent to about 5 per cent of the global GDP.

However, the negative effects of corruption are occasionally questioned. Some researchers argue that in certain circumstances corruption may have a positive effect on economic growth and efficiency (Khan & Sundaram, 2000; Leff, 1964).¹ Although a number of macroeconomic and microeconomic, theoretical and empirical studies support this view, corruption in most contexts has a wide range of destructive effects on societies' output growth and states' legitimacy (Rose-Ackerman, 1999; Rose-Ackerman & Palifka, 2016). In fact, recently all G20 leaders declared that corruption presents a serious obstacle to sustainable economic growth and the reduction of poverty which in turn poses a threat to financial stability and the economy in general. They concur that corruption destroys public trust and distorts the allocation of resources, thereby undermining the rule of law (G20 Leaders' Declaration, 2013). The overall

¹ It should be noted that Leff is now largely discredited (Hopkin, 2002), however Mushtaq Khan's arguments are more interesting as he discusses the importance of resource extracting corruption being negative and resource reinvesting corruption being, at times, more positive.

consensus is therefore that corruption has an adverse effect on economic growth and development (Malagueño, Albrecht, Ainge, & Stephens, 2010).

Since corruption represents one of the major obstacles to economic development, combating it has become a policy priority for all countries over the past twenty years (Graycar & Sidebottom, 2012). The United Nations Convention against Corruption (2004, p. 5) states clearly that “a comprehensive and multidisciplinary approach is required to prevent and combat corruption effectively”. Several international organisations, such as Transparency International and the World Bank, as well as government agencies, have developed different approaches towards combating corruption, although there is considerable disagreement about the best strategy to achieve this. Much recent research has suggested that the most suitable anti-corruption policies and programmes should be determined according to the level and type of corruption in each country, as well as the context within which it is taking place, because “one-size-fits-all” has been proven to be an unsuitable policy (Hough, 2013, p. 29; Huther & Shah, 2000).

A recent and advanced framework in the accounting world that was issued to mitigate the risk of corruption was the COSO Internal Control-Integrated framework. This accounting framework was originally released by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in 1992, and then updated in September 2013 to address changes in business environments and government activities, including expectations relating to combating and detecting corruption (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013). As will be explained later, this thesis utilises the COSO Internal Control Framework to evaluate and then to analyse the effectiveness of internal control in the public sector.

This PhD thesis starts with the research question and key definitions, followed by the purpose and significance of the study. Then, in Chapter One the theoretical assumptions and research design for the study are presented. Chapter Two offers an overview of how corruption is analysed and tackled from different schools of thought. The second half of the chapter provides a literature review regarding internal control, covering its development and usage, a synopsis of existing frameworks, its application in the public sector, the evaluation of its quality, and a discussion of its limitations.

In Chapter Three and Chapter Four, the first and second case studies are discussed. The final chapter, Chapter Five, concludes with a comparative analysis in light of different theoretical perspectives and recommendations for policy makers.

II. Research Question

This thesis aims to answer the following question:

To what extent is internal control effective in tackling corruption in government organisations?

III. Definitions of Key Terms

It would be beneficial to start with three key definitions before moving on to other parts of the research design:

In a broad sense, *internal control* is one of the foundations of sound governance. It consists of a set of management tools that are designed to provide reasonable assurance regarding the accomplishments of an organisation's objectives, such as:

1. Compliance with laws and regulations.
2. Reliability, validity, and transparency of financial and management reports.
3. Effectiveness and efficiency of operations, including the prevention and detection of misuse of assets, errors, fraudulent transactions and corruption (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013; Schick, 2014).

Typical examples of internal control include: internal audit, standards of conduct, and segregation of duties. It is vital to note that the definition of internal control has changed considerably in the last 20 years. Nowadays, internal control is not only used in accounting and finance, rather, it covers all areas of an organisation, including quality of governance (Hartmann, 2011; Pfister, 2009).

Internal audit, meanwhile, is an essential part of internal control that helps an organisation to achieve its objectives. As an independent and objective function, internal audit is responsible for evaluating the effectiveness and efficiency of internal control, and then making recommendations for enhancement (Schick, 2014).

Corruption is ‘the abuse of entrusted power for private gain’ (Transparency International, 2013). As explained in section (2.2.1), *corruption* is a contested term. Neither the United Nations Convention against Corruption nor the OECD Anti-Bribery Convention defines corruption. However, this thesis adopts this definition because it is globally recognised by several international organisations including the World Bank and Transparency International (OECD, 2013).

IV. Purpose and Significance of the Study

Research that analyses the causes of, and prospective cures for, corruption can be categorised into the following two groups. The first group represents research that relates corruption to what can be called ‘**societal factors**’. For instance, Treisman (2000, p. 399) investigates the relationship between corruption and the following six independent variables: religion, historical background, level of economic development, openness to trade, government structure, and democracy. He finds that countries with a protestant culture, British heritage, advanced economies, unitary state system, higher exposure to imports, or long exposure to democracy are, all things being equal, going to be less, rather than more, corrupt. These are, in a general sense, factors that will or could impact on countries at the level of the state. Further discussion of societal factors is presented in section (1.5.4).

The second group of research analyses the effects of what I call ‘**organisational factors**’ on corruption.² These factors include salary scale (Rose-Ackerman, 1999, pp. 45-72; Rose-Ackerman & Palifka, 2016; Søreide & Rose-Ackerman, 2006, pp. 68-73; Van Rijckeghem & Weder, 2001), job security (Rose-Ackerman, 2007, p. 497), employment of women (Dollar, Fisman, & Gatti, 2001; Goetz, 2007), nature of business

² Some authors (e.g. Bailer, Bodenstein, & Heinrich, 2013), call these ‘institutional factors’. I think ‘organisational factors’ are more general as they include not only rules and norms but also organisational culture and quality of leadership.

(Quah, 2001), state ownership (Boycko & Shleifer, 1996), competition (Rose-Ackerman, 2007, p. 8), and officials' discretion (Rose-Ackerman, 1978, p. 175). Further discussion of these factors and how they are related to corruption are presented in the Research Methodology Chapter (section 1.5.4).

Although internal control is often mentioned in the literature as a tool to fight corruption, some researchers question its usefulness and efficiency (Klitgaard, 1992, p. 27). In fact, some authors such as Anechiarico and Jacobs (1996, p. 150) argue that "too much (or the wrong kind of)" internal control could increase bureaucratic corruption.

As far as the researcher is aware, no empirical research to date has examined the relationship between internal control and corruption in government organisations. This can be attributed to two factors. First, corruption has only gained attention in the literature in the past twenty years. Empirical corruption research began to emerge in the 1990s using, or prompted by, corruption indices produced by Transparency International and the World Bank, and mostly tackles corruption from political and/or economic perspectives (Alberto Ades & Di Tella, 1997), not systematically from what can be termed a bureaucratic perspective. Second, and more importantly, there are difficulties associated with assessing the quality or effectiveness of internal control. As will be explained later, the updated version of the COSO Internal Control Framework was introduced in 2013 to facilitate the assessment of internal control.

This research intends to fill the gap in the literature by empirically and systematically testing and analysing the relationship between internal control and corruption in Saudi Arabian government organisations. If the hypothesis that *effective internal control leads to a lower perceived level of corruption in government organisations* is indeed valid then internal control could be recognised as a key factor among **organisational factors**.

Several articles and studies highlight the importance of this project. As stated by Monteduro et al. (2016, p. 47) in their recent review of anticorruption literature:

Most of the papers we found focus their attention on the relationship between public corruption and public governance in a macro-perspective of analysis, while only *a limited number of scholars* offer a reflection on the possible interdependencies between governance policies and instruments and

anticorruption efforts *at the level of the individual organization* (emphasis is from the researcher).

In particular, there is very limited accounting research on corruption in the literature (Morehead, 2007). As stated by Malagueño et al. (2010, pp. 375-376),

Empirical evidence that examines the relationship between accounting and corruption is scarce... the presence and quality of accounting systems, controls, and audits are often mentioned, though not empirically tested, in current literature...we consider the lack of empirical evidence to support an accounting-corruption connection to be a *major gap* within the existing literature (emphasis is from the researcher).

From the accounting literature perspective, O’Leary, Iselin, and Sharma (2006) and Kinney and William (2000) assert that there is a significant need for research on internal control. In particular, several scholars pinpoint the importance of examining the COSO Internal Control Framework to identify which elements are more effective in detecting fraud and corruption³ (Haron, 1996; Janvrin, Payne, Byrnes, Schneider, & Curtis, 2012). In fact, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013, p. 6) clearly states that its framework “should be the subject of academic research and analysis, to see where future enhancements can be made.” This thesis employs the COSO internal control to evaluate the quality of internal control in government organisations.

In conclusion, this project has several practical implications. First and foremost, taking into consideration the fact that the updated edition of the COSO framework was issued in 2013, this research is the first to examine this leading, global internal control framework and suggest enhancements to address the risk of corruption. Specifically, the most effective elements of this framework in terms of detecting and preventing corruption are identified. Therefore, special attention to these elements is required to alleviate corruption in highly corrupt government bodies, such as whether internal audit is a more effective tool for combating corruption than having a code of conduct. Finally, this research shows how significant it is to enact and enforce good internal control practices in government organisations as an effective means to combat corruption.

³ In accounting literature, accountants “rely more on the term *fraud* than *corruption* - perhaps on account of the former’s more legalistic connotation - these terms tend to imply the very same acts” (Everett, Neu, & Rahaman, 2012, p. 3).

Chapter 1

Theoretical Framework and Methodology

1.1 INTRODUCTION

In recent years, there has been a dramatic increase in the scope and extent of analysis of corruption, which includes studies on the causes, consequences and attempts to control corruption, from a variety of different ontological, epistemological and subsequently methodological positions.

In their recent book on the causes of corruption, Graaf, Wagenaar, and Maravić (2010) provide a comprehensive overview of alternative theoretical perspectives on corruption. They distinguish between eight schools of thought, namely “Weberian ideal-typical”, “structural functionalist”, “institutional economics”, “ecological”, “system theory”, “institutional design”, “post-positivist”, and “criminological” approaches (Graaf et al., 2010, pp. 17-19).

There is no need to unpack each of these perspectives here, suffice it to say that each of them falls into one of the following categories: individualism, institutionalism, or relativism (Torsello, 2013). Individualism starts from the premise that everyone acts rationally “to maximise her/his utility” (Kjosavik, 2003, p. 205). Institutionalism considers the causes and effects of economic factors (such as monopoly) and the political environment factors (such as democracy), on corruption. To put it differently, the basic assumption of institutionalism is that formal and informal institutions shape actors’ responses to given situations; consequently, they do not just choose how to behave based on what is best for them, they also take into consideration what the most appropriate response is – and that ‘appropriateness’ is moulded by the institutional context around them. Relativism stresses that culture, beliefs, values and religious background play a major role in shaping corruption in any country (Torsello, 2013).

Indeed, one could conclude that the conflict of views on how to control corruption stems from disagreement over the causes of corruption. While the most traditional and predominant approach sees corruption as a product of a rational cost-benefit analysis and adopts a largely technocratic approach both to understanding and counteracting it,

others consider cultural and moral differences and argue that corruption is derived from culture, society, structure, and agency interaction (Everett, 2012, p. 225). An emerging neo-institutional approach recognises a dialectical relationship between structure and agency by showing how corruption can become normalised and embedded in an organisation's operational processes (Ashforth & Anand, 2003; E. Brown & Cloke, 2004; Della Porta, 2012; Graaf et al., 2010; Palmer, 2008; Zaloznaya, 2014).

Since most anti-corruption mechanisms are modelled on a rational choice understanding of political affairs, the following section provides an overview of the most predominant rational choice theories as well as criticisms of them. Then, a brief background of historical institutionalism and the power of path dependency are provided as there is a new trend in the literature to analyse corruption from this perspective. After that, all underlying theoretical assumptions for this thesis and their justifications are presented, followed by the research methodology and design.

1.2 RATIONAL CHOICE THEORIES

In microeconomics, rationality is defined as human beings always wanting more rather than less of goods. However, considering scarcity issues, individuals have to allocate their resources efficiently. So, rationality assumes that people are rational and always compare costs to benefits before making decisions (Aregbeyen, 2011).

Political scientists and sociologists have borrowed the rationality concept from economists as it can be useful to understand the behaviour of individuals. The concept of rationality is often attributed to “rational choice theory”, which considers all human acts, even irrational ones, as purely rational actions⁴. This also means that rational choice theory is, for some, the ultimate ‘structural’ theory. Agents have no choice but to act rationally therefore, *all* people are structurally disposed to behave in the same way in terms of why they do what they do. (J. Scott, 2000).

The emergence of rational choice theory in political science first occurred during the second World War when behaviourists at the University of Michigan started to study and analyse voting behaviour in an attempt to forecast “party support and outbreaks of

⁴ This is a contradiction in terms. How can something be irrational and rational?!

war” (Hindmoor, 2010, p. 8). More pioneering work in the field of rational choice theory was conducted by Anthony Downs (1957). Downs (1957) discusses how politicians in power are self-interested and design their policies mainly to gain more votes rather than to serve the public’s best interest. Using a positivist approach and set of assumptions, he introduces a model to integrate political decision-making in economic theory (i.e. a general equilibrium theory). In his model, the principals represent the voters and the agents are the elected officials. The principals have imperfect information on whether the agents serve their best interest. At the same time, the agents do not know what the exact expectations of the principals are. This situation leads to undesired outcomes for both parties. In particular, there is no trust between the principals and the agents. The principals expect the agents to be self-interested and selfish, always seeking to maximise their own personal gains. The agents, on the other hand, are prepared to take any measures to maintain their positions even if these measures contradict the principals’ interests. Downs also illustrates that in democratic countries, elected officials (i.e. the agents) might find themselves betraying citizens’ (i.e. the principals’) best interest in order to be re-elected. As elected officials often need a tremendous amount of money to finance their campaigns, they might ‘sell’ policies to certain groups or corporations that contradict or at least do not serve the best interest of the voters.

There are three main features and assumptions of rational choice theories. First, individuals are always rational, self-interested, risk-averse, and act “instrumentally” by calculating all possible options and selecting the best way to achieve their objectives, which maximise their utilities (Eisenhardt, 1989; Hall & Taylor, 1996, p. 12). Second, outcomes of all actions are fully determined by individuals regardless of the surrounding environment. Third, a deductive approach is the only valid approach to explain and resolve issues (Hindmoor, 2010).

In the context of corruption, Rose-Ackerman states that “corrupt incentives exist because state officials have the power to allocate scarce benefits and impose onerous costs. Because scarcity lies at the heart of corrupt deals, basic insights derived from microeconomics can help structure efforts to reduce corruption” (1999, p. 39).

Under rational choice theories, two approaches are commonly discussed in the corruption literature: agency theory and rational choice neo-institutionalism (Torsello, 2013). These two approaches are discussed in the following sections.

1.2.1 Agency Theory

Agency theory, sometimes called the principal-agent model, deals with the conflict of interest issue between two parties (i.e. the principal and the agent). This theory attempts to balance the interests of both parties to achieve an equilibrium point where the agent acts in the best interest of the principal (Persson, Rothstein, & Teorell, 2013).

The principal–agent dilemma arises because the agents are motivated by self-interest and have informational advantages. Therefore, the agents are expected to act in their own best interest, taking advantage of what is called an “information asymmetry”, meaning the agents have more information than the principals (Swinkels, 2012). The principals, on the other hand, have the full authority to mitigate the risk of information asymmetry to ensure that the agents act in their best interests. Yet even when the principals implement the best mechanisms to mitigate the risk of information asymmetry, the agency costs, which represent the costs of the agent *not* acting in the best interest of the principal, are unlikely to be eliminated because it is not feasible to fully monitor the intentions and actions of the agents at all times (Miller, 2005).

The principal may minimize agency costs by implementing effective internal control (Arwinge, 2013; Campos & Pradhan, 2007; Swinkels, 2012), devising an “outcome-based contract” (Eisenhardt, 1989, p. 61), imposing appropriate sanctions, and hiring suitable agents (Hindmoor, 2010). In particular, several studies indicate that internal control systems could be utilized to alleviate possible misconduct arising from the agent’s informational asymmetry (Arwinge, 2013; Swinkels, 2012).

In the corruption literature, the principal-agent model is found to be a widespread strategy for combating corruption (Ahmad & Giorgio Brosio, 2006). It is attributed mainly to the seminal work titled “Corruption: A Study in Political Economy” by Susan Rose-Ackerman in 1978 (De Graaf, 2007, p. 47). As Rose-Ackerman points out, public officials are rational; thus, they do not commit corrupt practices unless the benefits

outweigh the consequences of corruption. She also notes that corruption occurs “because bribes can pass unobserved and because officials have broad discretion to make case-by-case determinations that cannot easily be checked by superior officials” (Rose-Ackerman, 1978, p. 175). Rose-Ackerman’s idea can be illustrated by the following formula: $\text{corruption} = \text{benefits derived from corruption} + \text{discretion} - \text{costs of corruption}$. In 1988, Robert Klitgaard developed Rose-Ackerman’s formula and suggested that “ $\text{corruption} = \text{monopoly power} + \text{discretion} - \text{accountability}$ ” (Everett, 2012, p. 228).

In other words, the agency theory argument demonstrates that there are three main reasons why corruption exists: the first is that bureaucratic corruption can arise as a result of an official abusing his position in the name of self-interest; the second is the fact that the existence of government programmes creates opportunities for corruption that otherwise would not exist; and the third is the imbalance of information between officials and their superiors, known as information asymmetry, that exists in the principal-agent relationship (Hamilton-Hart, 2001; Rose-Ackerman, 1999; Rose-Ackerman & Palifka, 2016). Therefore, a great deal of corruption research proposes a number of strategies as anti-corruption solutions, based on these three categories.

1.2.1.1 The relevance of agency theory to this thesis

Agency theory assumes that people are always rational and never commit corrupt practices unless they find that the benefits derived from corruption exceed the cost of corruption. In this context, internal control could be used as a technocratic tool and top-down approach to increase the cost of corruption (Serra, 2012). Also, internal control could be used to minimise agency costs, which represent the costs of the agent not acting in the best interest of the principal (Campos & Pradhan, 2007; Swinkels, 2012). Arwinge (2013, p. 2) asserts that agency theory could “provide explanations for how controls are adopted” by institutions.

Although agency theory is the dominant and simplest approach adopted by many policy makers to build their anti-corruption reforms, it has been widely criticised for making a number of assumptions, including the following:

- The existence of a clean, active and powerful principal (Ahmad & Giorgio Brosio, 2006; Campos & Pradhan, 2007; Persson et al., 2013; Rose-Ackerman, 1999; Rose-Ackerman & Palifka, 2016; Swinkels, 2012)⁵;
- A political environment where corruption is rejected by both politicians and the general public (Brinkerhoff, 2000; Hough, 2013; Levitsky & Murillo, 2009; Neu, Everett, & Rahaman, 2013; Sargiacomo, Ianni, D'Andreamatteo, & Servalli, 2015; Szeftel, 1998)⁶; and
- The availability of economic resources to implement and maintain anti-corruption reforms (Asongu, 2013; Noor, 2009)⁷.

This research understands and illustrates agency theory assumptions as shown in Figure (1.1). As discussed in the following section, one can understand why, by taking these assumptions for granted, many countries failed in their implementation of anti-corruption reforms.

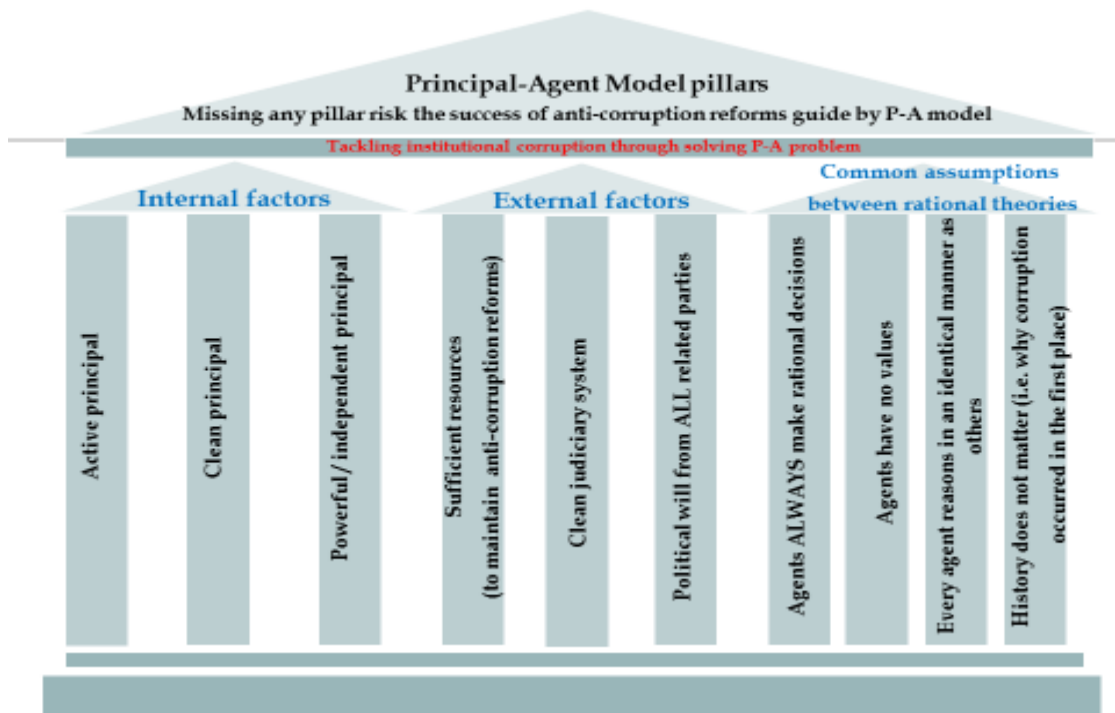
⁵ For instance, Persson et al. (2013) study unsuccessful anti-corruption reforms in countries with systemic corruption. They conclude that these reforms failed to curb corruption because they are based on the principal-agent theory. This theory assumes that corruption lies solely with agents who betray principals' interests for personal gains. On the other hand, the principals are presumed to be active in protecting the public interest by monitoring the agents' behaviours. So, if the principals are corrupt or inactive, which is often the case in countries with systemic corruption, the theory becomes unsuitable for building anti-corruption reforms.

⁶ For example, Szeftel (1998) explains how corruption in Africa is addressed from a political governance perspective. He notes that anti-corruption policies and strategies, including privatisation, deregulation, education, and democratization, are unlikely to succeed unless the pillars of honest political environment exist. Also, Neu et al. (2013) examine how politicians influence the professional judgments of internal government auditors in a major corruption case in Canada. Their findings suggest that high-profile politicians have the discretion to frame internal audit function and internal control; thus preventing internal auditors from discovering and reporting on possible corrupt practices.

⁷ Noor (2009) develops a strong case in which he shows how corruption is widespread in Pakistan due to public officials being paid less than their basic needs.

Figure 1.1

Agency theory assumptions



Source: own design

This leads to the following approach to analysing corruption, ‘rational choice neo-institutionalism’, which addresses some of the agency theory weaknesses.

1.2.2 Rational Choice Neo-institutionalism

Both agency theory and rational choice neo-institutionalism (sometimes called collective action theory) are branches of rational choice theory and build on the assumption that actors are always rational and make a costs-benefit analysis before taking any decision.

This theory suggests that individuals in a small or large group must work together to attain their objectives (Hindmoor, 2010). However, Olson (2002, p. 1) disagrees with scholars who assume that if individuals’ objectives match the group objective,

individuals are “logically” expected “if they are rational and self-interested, [to] act to achieve that objective”.

Rational choice neo-institutionalism models,

...question the underlying assumption that all societies hold at least one group of actors willing to act like “principals” and, as such, enforce such regimes. This is because, quite contrary to what principal–agent theory suggests, collective action theory contests the view that strategic situations always in themselves give the actors the answer to the question what strategy is the most rational to opt for. This is particularly true for strategic interaction that takes the form of a multiple-equilibria coordination problem, within the framework of which—unlike in the more commonly put forward single-equilibrium “prisoner’s dilemma,” which always has a dominant strategy—what action should be taken should be expected to depend on shared expectations about how other individuals will act. (Persson et al., 2013, p. 456).

By examining the systemic corruption in both Kenya and Uganda, Persson et al. (2013) show how rational actors react in a situation where everyone acts corruptly. In essence, these rational actors engage in corruption even though they morally condemn corruption and understand the consequences of corruption in their countries.

Rational choice institutionalism scholars argue that rationality is always bounded - i.e. what is rational for someone in one context might not be rational for someone in a different context. So the corruption equilibria are expected to be different in different places as there is no one rationality that applies to everyone. Furthermore, scholars in this field assert that rational actors make choices which end with products – i.e. institutions. Institutions only exist because individuals want them to and therefore, in theory, individuals can change them (Persson et al., 2013; Rothstein & Teorell, 2015; Teorell & Rothstein, 2015).

1.2.2.1 The relevance of rational choice neo-institutionalism to this thesis

The theory of rational choice neo-institutionalism assumes that actors behave in a rational manner based on their cost-benefit calculations. They engage in corruption if the benefits of doing so exceed the costs. Both the costs and benefits are determined by the corruption equilibrium, or the extent of corruption that exists in the organisation at that time. This sets the organisational context, which is an extremely important part of

the cost-benefit analysis to be deployed by a rational actor when deciding whether or not to engage in corrupt practices. Therefore, an organisation could theoretically manipulate actors' behaviour by changing its internal control settings, i.e. the incentives for, and constraints on, corruption. These incentives and constraints do not only include things of monetary value (i.e. hard internal control), but also intangible factors (i.e. soft internal control) such as status and recognition (rewards) and training and education (constraints). Rational choice neo-institutionalism claims that the corruption equilibrium can change, albeit slowly over time, as the cost of (and benefits from) engaging in corrupt practices change. Based on this, one would expect different levels of corruption in government organisations as their soft, hard, and monitoring controls are created by a different set of rational actors, i.e. rationality is different based on different historical, cultural, moral, and educational levels as well as the strategic objectives of different actors (Persson et al., 2013; Rothstein & Teorell, 2015; Teorell & Rothstein, 2015).

The strengths of rational choice neo-institutionalism lie in the way it addresses some of the weaknesses of agency theory by making a new assumption: that individuals can act together as a collective principal. More importantly, unlike agency theory, this theory considers the impact of soft control elements of COSO internal control such as the tone at the top. In other words, the theory recognises that rational actors might engage in or refrain from indulging in corruption because of the influence of high or low institutional integrity. However, rational choice institutionalism still falls under the umbrella of rational choice theories, and therefore it shares many weaknesses of agency theory. For instance, rational choice neo-institutionalism does not explain how government institutions got their levels of corruption in the first place. In essence, this theory does not explain history, at least not as rigidly as historical institutionalism, but it describes it. It assumes that institutions exist because rational actors want them to. It considers the fact that things evolve but it does not explain how they started (Persson et al., 2013; Rothstein & Teorell, 2015; Teorell & Rothstein, 2015).

It is like Charles Darwin's theory of evolution, in which he showed evidence of evolution having occurred, but he could not explain how life actually started, i.e. how the first living organism came to exist. Darwin was not able to explain how life began and, despite the theory of evolution being considered as one of the most persuasive

theories in science, Darwin could not provide evidence as to how life started. The same logic applies to rational choice neo-institutionalism - the rational choice scholar cannot explain how corruption started.

1.2.3 Criticism of Rational Choice Theories

Rational choice theory has been under attack since its inception. While some rational choice theorists consider it to be a revolution in political science, opponents “argue that it is all mouth and no trousers; that its success marks the triumph of dazzling technical style over explanatory substance” (Hindmoor, 2010, p. xiii). The main criticisms of rational choice theories can be summarised in four points.

First, individuals are not perfectly rational. Instead, they are either boundedly rational, which is the case most of the time, or irrational. However, from the perspective of rational choice theories it is impossible to find irrational people. Bounded rationality suggests that individuals do not conduct effective scenario analysis when considering all possible options. Therefore, they select options based on their limited knowledge and information (Hindmoor, 2010). Proponents of bounded rationality believe that absolute rationality “has never been applied, and can never be applied - with or without the largest computers – in the real world” (Simon, 1983, p. 14).

Second, individuals do not always act out of self-interest, selfishness and “opportunism” as presumed in rational choice theory (Vital, Gachter, & Konigstein, 2002, p. 6). In reality people sometimes make decisions just to fulfil their commitment to their beliefs or values knowing that these decisions contradict their own best interest and might have severe consequences. This poses “a wholly arbitrary limitation” on rational choice theory (Sen, 1977, p. 342).

Third, rational choice theories are built on Adam Smith’s thought which supposes that people are “guided by instrumental rationality” (Elster, 2001, p. 117). This contradicts the Emile Durkheim school of thought which suggests that social norms and culture shape or constrain the behaviour of people (Elster, 2001). Therefore, individuals are not driven “by instrumental considerations of self-interest” (Hindmoor, 2010, p. 124). As stated by (De Graaf, 2007, p. 48) rational choice theories focus “on a specific situation

of an agent (a corrupt official) ... however, it is insensitive to the larger social context... It cannot account for triggering causes within the situation". In other words, these theories do not explain why corruption occurs in the first place⁸.

Finally, since rational choice theories assume that everyone reasons in an identical manner, they ignore the fact that each individual thinks differently (Hindmoor, 2010).

In response to these criticisms, rational choice theory, in its entirety, offers probably the only straightforward solution to corruption that has been widely implemented. As it is based on rationality and on actors making cost-benefit analyses, policy makers can understand it. This helps policy makers because it predicts that if they make the costs of corruption higher than the benefits, public officials will not become corrupt. This therefore makes the creation of policy based on this theory relatively simple (Ahmad & Giorgio Brosio, 2006). Therefore, it is not appropriate to stop using rational choice theories without having a substitute (Hindmoor, 2010 quoting Shepsle, 1996).

1.3 HISTORICAL INSTITUTIONALISM⁹

A new trend in corruption research is to apply historical institutionalism to understand the nature of corruption (e.g. Hellmann, 2015). The fundamental feature of the historical institutionalist approach is path dependency, which states that once an organisation is set on a path to a particular level of corruption (whether that is a high level of corruption or a low one), it becomes likely that the organisation will stay on that path. This is due to the inherent conservatism of the people working in the organisation (Marsh & Stoker, 2010).

⁸ Hindmoor (2010, pp. 124-125) presents an excellent argument between sociologists and rational choice theorist, which I have not covered in this dissertation.

⁹ This section discusses historical institutionalism in the context of the corruption literature. For further background information on the origin and evolving of institutionalism in general, refer to Marsh and Stoker (2010). In essence, institutionalism with its 'common sense' approach dominated political and government analysis until the 20th century. Between the 1950s and 1960s, the behavioural revolution started to materialize. The main differences between institutionalism and behavioural approaches are the focus of analysis being shifted from process and macro level analysis to the outcome and micro level analysis. In particular, scholars of institutionalism emphasise how institutions shape social actors' behaviour, not the other way around. They do this by detailed description of rules and norms over time and across countries and *then* attempt to explain the impact of these rules and norms on the subject under investigation. In contrast, behaviouralism concern is primarily on how and why social actors or individuals behave in certain manners with much stress on observable behaviour, empirical testing, replication, and objectivity.

1.3.1 The Relevance of Historical Institutionalism to this Thesis ¹⁰

Based on this theory, public officials would normally be expected to be resistant to change, meaning that the imposition of “top down” anti-corruption controls will, on their own, be unlikely to radically alter the levels of corruption without a concerted effort to change the culture of the organisation at the same time. This therefore makes the level of corruption within an institution difficult to alter.

The strength of this approach is that a deep analysis of case studies is made with regard to an organisation’s origins. Studies that explore corruption through the lens of historical institutionalism analyse how an organisation was set up, and show how this process can affect the way an organisation works, even many years later. This is considered to be a disadvantage of rational choice institutionalism which does not explain how an organisation reaches a particular level of corruption.

However, the historical institutionalism approach does have its criticisms. If applied rigidly, it makes change impossible and therefore it fails to predict changes that can occur rapidly.

Some scholars have argued that this weakness is also its strength as it should focus policy-makers on institutions’ cultural norms and values, rather than implementing hard controls on corrupt practices, which this thesis argues is the most effective way to change the levels of corruption in an institution.

Another strength of this approach is that it explains the continuity of corruption within an organisation, as one thing that can be asserted with confidence about corruption is that it does have continuity - i.e. it is very hard to get rid of. Even when implementing what look like effective anti-corruption tools, corruption persists and officials will imitate their corrupt colleagues. Corruption becomes the pathway to overcoming these tools, and resistance to them is strong. Historical institutionalism is good at getting its teeth into these problems but it takes a more conservative approach to predicting the future, having a less optimistic view of the impact of anti-corruption reforms than the

¹⁰ For further discussion of the relevance of historical institutionalism to corruption, refer to (Hellmann, 2015)

other approaches. This pessimistic view means that the solutions that historical institutionalism provides tend to be more radical than other approaches, taking a more root-and-branch approach to reform than the “top down” solutions the other approaches provide (Hellmann, 2015).

1.4 THEORETICAL ASSUMPTIONS

1.4.1 Theoretical Framework for this Study

Typically, there are two ways of writing an academic research thesis. One is to have an explanation or framework and then apply this framework as a guide to the research process. Most researchers follow this and find themselves instinctively employing the language of their chosen approach. The other way is to take the most useful and relevant ideas from two or more frameworks to create a hybrid explanation, and then apply this hybrid framework to the thesis. The latter is the approach taken in this research – opening itself to insights from alternative corruption theories on offer.

This thesis uses insights from historical institutionalism, agency theory, and rational choice neo-institutionalism and applies them to the studies at hand. This does not mean that it has bought into all of their assumptions, however it uses these three approaches to understand what happens in both funds’ contexts in order to capitalise on the strengths of each approach, and to overcome the weaknesses of each of them.

This research focuses more on analysing corruption, rather than internal control, through the lens of corruption theory for two main reasons. The first and most important one is that the main aim of this research is to examine the impact of internal control on corruption; therefore, it does not take the impact of internal control on corruption for granted as there is no empirical evidence that shows the impact of internal control on corruption. In fact, as explained in section IV, some scholars argue that internal control could lead to higher levels of corruption (Anechiarico & Jacobs, 1996; Klitgaard, 1992). The second reason is to rule out other rival hypotheses by using insights from corruption theories to understand why each fund has higher or lower levels of corruption, away from the COSO framework perspective. In other words, the study attempts to uncover

other factors besides internal control that have affected corruption in both funds, which is not captured by the COSO Internal Control Framework.

As the previous discussion made clear, the theoretical approaches introduced here have its own strengths and weaknesses. By applying only one corruption theory as a theoretical framework, research will not only be limited to insights from that particular theoretical perspective, but it must also accept all the theoretical framework's assumptions. For instance, by having the agency theory as a theoretical framework, a researcher must blindly accept all agency theory assumptions even though the corruption literature shows that the successful application of agency theory wholly depends on the existence of ALL its assumptions (see figure 1.1). Obviously, this would have been easier to do, but the outcome of such research would have been questionable, especially to those who do not accept the agency theory assumptions.

As a result, the researcher has opted to be open to insights from the main corruption theories whilst examining the effectiveness of the COSO internal controls in tackling corruption in the case studies. In other words, this research has effectively created its own explanation based on a set of assumptions that will be outlined. This has been a two-way process, in that the three competing theoretical approaches are applied to the analysis of the COSO framework in both case studies' contexts, and that the feedback from the COSO framework is applied to the three theoretical approaches in order to gain the most useful insights from this study. This thesis carries out this process in the following chapters:

In Chapters Three and Four, it rigidly applies COSO Internal Control Framework to evaluate the effectiveness of internal control in both case studies in order to pinpoint the most important elements of that framework in tackling corruption. In Chapter Five, the research takes the most useful and relevant ideas from the most prescient theoretical frameworks in the corruption literature to understand how each government institution reached its level of corruption. The aims of this are: to gain a deeper understanding of the case under investigation; to explore different organisational practices, meanings,

and insights through multiple theoretical lenses¹¹; to engage in the corruption debate; to enhance the generalisability of this thesis; and to rule out rival hypotheses.

In the same chapter, the strengths and weaknesses of each theoretical framework are discussed in light of the research findings in both case studies, i.e. whether each corruption theory could accurately explain and diagnose the different levels of corruption in case studies - does it match the findings of this research obtained from interviews, observation, and documents analysis from the real world?

1.4.2 Hypotheses

This research tests the following hypotheses:

H1: an effective internal control leads to a lower perceived level of corruption in government organisations.

If evidence can be found to support this hypothesis, internal control could qualify as an indicator of genuine political will to fight corruption. In particular, international organisations concerned with evaluating the perceived level of corruption in different countries could consider enacting and enforcing good internal control practices in the public sector as a signal of genuine desire to eradicate corruption. Second, internal control could be used to differentiate between highly corrupt or least corrupt government organisations. In particular, government agencies with better internal control design and enforcements are more likely to be less corrupt than other government organisations. This would help anti-corruption agencies, researchers, citizens, rating agencies, media, politicians, civil societies, and the private sector in different ways. For instance, it would help anti-corruption agencies to identify high-risk government bodies and hence allow them to take proactive measures to mitigate corruption risks. On the other hand, politicians and citizens could demand remedies in government bodies with poor internal control in order to protect economic growth and save taxpayers' money from embezzlement.

¹¹ An increasing number of scholars encourage researchers in organisational and accounting research to apply theoretical triangulations (e.g. Hoque, Covaleski, & Gooneratne, 2013)

Also, based on the study's theoretical framework, the following hypotheses are developed.

H2: an effective internal control leads to a lower perceived level of corruption when there is an active principal

H3: an effective internal control leads to a lower perceived level of corruption when there is a clean principal

H4: an effective internal control leads to a lower perceived level of corruption when there is a powerful and independent principal

H2, H3, H4 reflect recent arguments in the corruption literature that anti-corruption solutions guided by the principal/agent model are unlikely to succeed where there is no clean, active, and powerful principal (see figure 1.1).

Furthermore, based on rational choice neo-institutionalism, the study expects the following hypothesis to hold:

H5: an effective internal control leads to a lower perceived level of corruption when the corruption equilibrium is low.

From the historical institutionalism perspective, the following hypothesis is tested,

H6: an effective internal control leads to a lower perceived level of corruption when it was established appropriately.

And finally, and based on a great deal of recent research that supports exploring internal control through multi-theoretical lenses, this thesis tests whether all relevant corruption theories could provide a better explanation for different levels of corruption than just the predominant agency theory,

H7: the effectiveness of internal control in tackling corruption is better understood with theoretical triangulation.

1.4.3 Why Saudi Arabia?

There are four main reasons that justify why this research has been conducted in Saudi Arabia. Firstly, corruption is a very sensitive topic and there are many challenges associated with investigating this subject, especially in developing countries. However, researchers are more likely to be able to overcome these challenges if they conduct the research in their own countries, where they are very familiar with the culture, norms, and legal systems. Also, corruption researchers are more likely to have good connections in their countries that will enable them not to only gain access to government organisations, but also to gather more information about their case studies¹². From financial and logistical perspectives, it is more feasible to conduct the study in the researchers' countries.

Secondly, the Saudi government encourages corruption research. The National Strategy for Promoting Integrity and Combating Corruption, which is approved by the Council of Ministers decree number 43 dated 19/2/2007, clearly urges all government organisations to support corruption research and to make all their information available to corruption researchers. This provided the legal grounds for this research to gain access to government organisations under investigation.

Thirdly, the researcher is not aware of any country in the world that has produced its own corruption index other than Saudi Arabia. The Saudi Corruption Index (see section 1.4.5 in this thesis for more on this) helped in the case study selection process as it identified different levels of corruption in Saudi government organisations, i.e. a dependent variable of this study. That does not mean that cases were selected on the dependent variable, as will be explained later in this chapter.

The final reason for selecting Saudi Arabia is that the country is not an insignificant player on the international stage, being the world's predominant crude oil supplier, and also a member of the G20 group of the world's most powerful economies. Despite this fact, there has been very limited corruption research in Saudi Arabia. Most corruption research has taken place in democratic countries (e.g. Rothstein & Teorell, 2015;

¹² E.g. during the fieldwork of this study, one manager in Fund B refused to allow me to interview his staff. I coincidentally met this person in my neighbourhood and he asked me about the progress of my research. I told him it was good, but it would have been better if he had cooperated with me. He then asked me to visit his department and meet all his staff.

Teorell & Rothstein, 2015) or countries undertaking the process of democratisation (e.g. Noor, 2009). Clearly, there is a lack of corruption research in countries with absolute monarchies, so this research is long overdue and would start to fill this gap in the literature.

1.4.4 Determining the Principals and the Agents for this study

Principals are defined for this study as individuals or boards of directors who employ internal control to tackle corruption. To achieve this, the principals must have the ultimate authority to:

1. Lay down, modify, implement, enforce, and monitor internal control to achieve their objectives (i.e. employing effective internal controls to fight corruption)
2. Reduce agents' informational advantage in order to ensure that agents act in their best interests.
3. Control and compensate their employees (i.e. public employees).

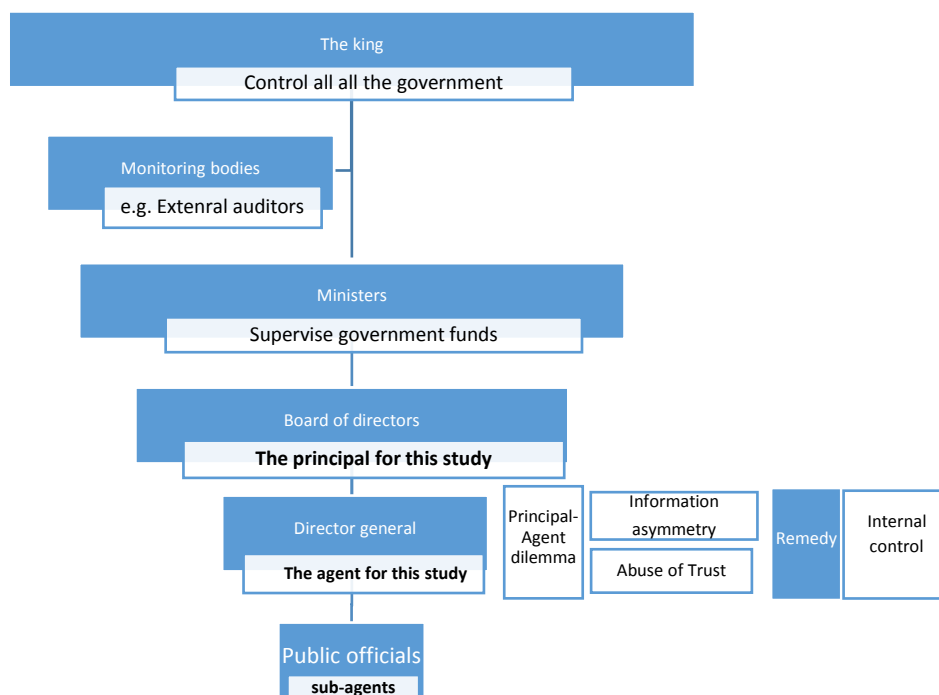
Internal Audit Regulations in Saudi Arabia lay the responsibility of establishing effective internal control on the highest authority of each government organisation. The highest authority in government entities is either a minister as stated in article (10) of The Saudi Law of the Council of Ministers, Royal Order (No. A/13) dated 21/8/1993, or a board of directors in an independent government organisation and state owned enterprises (Al-Fadhel, 2012). Article (14) of Internal Audit Regulations requires each internal auditor of government organisations to evaluate the effectiveness of the internal control and report any deficiency to the highest authority within each government organisation within 90 days of the end of each year. Then, the highest authority has full discretion to decide whether to take action on the internal auditor's recommendations (Alzeban, 2010). It should be noted that such practice may indicate weak governance in Saudi government structures. As noted by Al Abas (2013), internal control in Saudi government organisations should not be left to the head of government agencies. He suggests establishing an audit committee in each government agency to take responsibility for internal control.

The agents in this study are bureaucrats, appointed by the principal who work in accordance with their directions, policies, and procedures to achieve certain objectives.

Figure (1.2) illustrates the relationship between the principal, the agent, and sub-agents in this study.

Figure 1.2

Principal-agent model in the context of this study



Source: own design

As shown in figure (1.2), the king is the highest authority in Saudi Arabia. He employs various tools to monitor the performance of ministers, directors of independent government organisations and state-owned enterprises. This includes the Shura Council, the General Auditing Bureau, and the Ministry of Finance (Alzeban, 2010).

The Shura Council is the parliament in Saudi Arabia. All members of this council are appointed by the King. Besides revising laws and regulations, the council is responsible

for reviewing and evaluating the performance of government organisations and then making recommendations to the King (Al-Subaie, 2013).

The General Auditing Bureau acts as an external auditor for all government entities and state-owned enterprises¹³ to ascertain that all government revenue and expenditure is in line with applicable laws and regulations (Alzeban, 2010).

The Ministry of Finance plays a major role in preventing government organisations from spending public funds inappropriately. As stipulated by Royal Order (M/85), each government entity must have a representative from the Ministry of Finance to review its expenditures *before* they get paid (Alzeban, 2010).

1.4.5 Dependent Variable: The Saudi Corruption Index ¹⁴

This research uses the Saudi Corruption Index (2014) to measure the level of corruption in government organisations in order to select the most appropriate case studies. Before doing so, this research assessed the rigorousness and authenticity of the Index using three distinct tests: benchmarking the Index against other indices used in the corruption research literature; reviewing the index's methodology to ensure its reliability and validity; and checking to what extent the Index's conclusions broadly agree with the findings of the most influential research literature on this subject.

Benchmarking the Index against other indices meant comparing its approach to other, well-established corruption indices. In line with best international practices and with corruption indices such as the Worldwide Governance Indicators (WGI) produced by the World Bank and the Corruption Perceptions Index (CPI) published by Transparency International, the Saudi Corruption Index adopts a mixed approach when measuring the perception and experience of corruption from all related parties (i.e. government, private, and civil societies). As stated by the (OECD, 2013, p. 7), corruption perception indices “have been widely used in empirical research ... [and] remain in fact, a

¹³ State-owned enterprises include any company of which the Saudi government owns at least 25 per cent of its capital.

¹⁴ This section is based on the Saudi Corruption Index Report which is owned by the National Anti-corruption Commission (2014). The full report is available with the researcher in case anyone needs to view it.

reference for people and both business and political leaders to make decisions, explaining their use in gauging corruption.”

The Saudi Corruption Index (2014) covers 37 government organisations and state enterprises. The index was prepared by the most reputable and oldest academic institution in Saudi Arabia (i.e. King Saud University), and the final version of it was evaluated by two external academic referees (National Anti-corruption Commission, 2014). The index rates the government organisations on a scale of 0 to 100 with 100 being the least corrupt. The index reflects the two sides of the corruption equation: representing the demand side is the experience and perceptions of 6692 government officials; and representing the supply side are 2648 residents, 362 business people, and 1015 activists from civil society.

The second test was to review The Saudi Corruption Index’s methodology. The index employs a stratified sampling technique, dividing Saudi Arabia into groups in accordance with the Saudi Arabian Population Census 2010. This technique is generally perceived to be more efficient, and more representative of the population, than a simple random technique (Cooper & Schindler, 2014). This is especially true in a country like Saudi Arabia where random sampling may use respondents from the three most populated cities (where at least half the Saudi population live) whereas the targeted population is located in 258 cities.

This sampling technique involved splitting all the cities in Saudi Arabia into six groups based on total population: under 5,000; 5,000 - 9,999; 10,000 – 49,999; 50,000 – 99,999; 100,000 – 499,999; and finally those cities with a population over half a million. All cities were then further divided up into the 13 provinces that make up Saudi Arabia. From these, the cities from all provinces with populations under 5000 were removed, leaving 258 cities in total, divided into 65 groups (i.e. the five remaining groups by size of population, further divided by the 13 provinces). From these 258 cities, 55 were selected using SPSS complex sampling, ensuring that all 13 provinces were represented.

The report used to explain how the Saudi Corruption Index was compiled went into a great level of detail, showing precisely how the index was calculated, and also providing a list of companies and not-for-profit organisations that were surveyed and/or

interviewed. The methodology used to compile the Index gave the surveys a weighting of 70 per cent while interviews had a weighting of 30 per cent.

In the process of developing the index, both validity and reliability tests were conducted. In particular, ten referees were asked to assess how well each question in the survey was written in terms of clarity, and in reflecting what it was supposed to measure (i.e. validity). The feedback from these referees was generally satisfactory as there was a consensus on the validity of more than 70 per cent of these questions. The reliability test was also conducted utilising 120 surveys. As per Cronbach's alpha measurement, the result was 0.83625, indicating that there was a high consistency if measurement repeated again (National Anti-corruption Commission, 2014).

The final test was to check the extent that the Index's conclusions were supported by the most influential research on this subject. The findings of this index are supported by some of the most influential scholars on government corruption. For instance, Rose-Ackerman's 2007 study concludes that state enterprises that are partially owned by the government but have no monopoly have less corruption than enterprises that are fully owned by the government (Rose-Ackerman, 2007). One of the conclusions that could be drawn from the Saudi Corruption Index is that this is also the case within Saudi Arabia.

The Saudi Corruption Index's sound methodology allowed the researcher to make rigorous statistical comparisons and assumptions. This has meant that the research has been able to build on it in measuring the level of corruption in both institutions under investigation. This is not to say that there is no problem with the measurement of corruption. Chapter Two elaborates on the methodological and theoretical challenges in this area.

1.4.6 Independent Variable: COSO Internal Control Framework

After reviewing the most common internal control frameworks¹⁵, the updated edition of the COSO Internal Control Framework was selected to assess the quality of internal control in government organisations. It was done so for the following reasons:

Firstly, it is the only framework that codifies internal control concepts into principles and attributes to ease the assessment of the effectiveness of internal control. According to D'Aquila (2013),

“The updated framework now contains 17 principles in order to more clearly explain the original framework’s five components...The 17 principles are, perhaps, the most significant enhancement in the updated framework. They provide clarity regarding the role of principles in designing, implementing, and conducting internal control as well as *assessing its effectiveness*” (para. 15). [Italics from the researcher]

This research employs these principles as objective parameters when evaluating the quality of internal control in government agencies. Then, the researcher attempts to determine which principles are more effective in combating corruption.

Secondly, the COSO framework was issued in September 2013 after careful consideration had been given to all previous internal control models and guidelines; therefore, it is the most recent and advanced internal control framework. As stated by COSO (2013) in Stage One of developing the project, which started in November 2010, a review of the literature and different sources of input was conducted to identify the challenges involved in implementing the original COSO framework (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013). As a result, COSO amended the original framework to address these challenges and fulfil the expectations of all related parties.

Thirdly, the updated COSO framework is expected to fit well in the public sector as some government officials were involved in the development of this framework. Furthermore, deficiencies highlighted by ANTOSI Internal Control Standards for Public Sector have been addressed, including expectations related to preventing and

¹⁵ Alternative internal control frameworks are discussed in Chapter Two.

detecting corruption. In fact, when comparing ANTOSI standards with the updated COSO framework, it is obvious that COSO addresses the issue of corruption in greater detail in a separate section whereas ANTOSI stresses the importance of considering the risk of corruption in general and within the context of risk assessment without explaining how corruption is related to internal control components or giving examples of factors that increase the risk of corruption (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013; The International Organization of Supreme Audit Institutions, 2004). It should be noted that none of the internal control frameworks presented in Chapter Two explicitly address the issue of corruption.

Fourthly, in contrast with other internal control frameworks, the COSO framework is considered “a leading framework” for assessing internal control effectiveness (D'Aquila, 2013, pp. 22-23). Furthermore, the original version of COSO, which was issued in 1992, represents the foundation of most internal control frameworks issued afterward (Mafiana, 2013).

Fifthly, since the updated COSO framework was published recently, no research has been conducted to examine its suitability for the public sector, which adds more value to this research in terms of contributing to internal control literature in this regard.

Finally, the COSO framework was developed by experts from various countries; therefore, it was customised to be applicable in any country. It should be noted that several governments in the world have adopted internal control in their public sectors based on the original edition of the COSO framework. These include Australia, Sweden and the USA (Sarens, Visscher, & Gils, 2010). In the context of Saudi Arabia, Auditing Standard number 11 copied the main components of the COSO Internal Control Framework.

1.5 METHODOLOGY AND RESEARCH DESIGN

1.5.1 Methodology

Methodology refers to the “strategies of enquiry” or procedure whereby a researcher selects the most appropriate “type” of quantitative, qualitative, or mixed methods for

their research (Creswell, 2008, p. 7). The literature review reveals that quantitative methods could be used with caution to measure the effectiveness of internal control. In order to avoid what is called the “check box mentality”, more recent research suggests that qualitative approach should be employed when testing the quality of internal control (Bierstaker & Thibodeau, 2006, p. 886). In his recent book titled “Internal Control: A Study of Concept and Themes” Arwinge (2013) presents a very comprehensive overview and discussion of the internal control literature. He recommends the use of a qualitative approach to understand how organisations “design, apply, and oversee their systems of internal control” (Arwinge, 2013, p. 111). He highlights that “conventionally” auditors have employed qualitative methods when assessing the effectiveness of internal control (Arwinge, 2013, p. 111). For these reasons, this thesis adopts a qualitative approach to address the main research question. Furthermore, since “internal control is an inherently complex concept,” qualitative methods could provide a better understanding of the nature and the complexity of issues under study and ensure that the most vital issues are considered (Arwinge, 2013, p. 147).

Qualitative research has different meanings depending on the philosophical perspectives underpinning each piece of research. However, generally speaking a qualitative research method involves practices that assist a researcher in understanding and interpreting the issues under investigation in “their natural settings” (Denzin & Lincoln, 2011, p. 3). These practices include but are not limited to observation, case study, interview, and personal experience (Denzin & Lincoln, 2011).

1.5.2 Research Approach

Qualitative research deploys either deductive or inductive logics. ‘Deductive thinking’ is the process of reasoning to test concepts and theories in order to come up with a logical conclusion whereas ‘inductive thinking’ or reasoning is used to develop concepts or hypotheses via collecting and analysing data (Flick, 2014, p. 408). This thesis employs a deductive approach to test hypotheses presented in section (1.4.2).

1.5.3 Research Design

Research design acts as a road map to guide a researcher in the process of collecting and analysing data in order to answer the research questions properly (Johnson & Reynolds, 2012).

This research seeks to develop an explanation and analyses the relationship between the level of corruption (i.e. the dependent variable) and internal control (i.e. the independent variable) in government organisations. To do so, it is vital to keep the potential effects of all other known independent variables constant or at least under control to uncover the relationship between the two phenomena.

According to Lijphart (1971), there are four main basic scientific methods to establish an empirical relationship between two or more variables under investigation while keeping the potential effects of all other variables constant. These methods include the comparative method, the experimental method, the statistical method, and some types of case study methods.

The key feature of the experimental method in comparison with other methods is the rigorousness of controlling the potential effects of all other variables. Furthermore, the main difference between the statistical, comparative, and case study methods is the number of cases. The more cases included in the comparison, the more likely the statistical method is employed¹⁶ (Burnham, 2004).

“Most similar systems” along with “the method of difference”, “the method of agreement”, “the method of concomitant variations” and “the most different systems” represent the most fundamental forms of comparative method (Marsh & Stoker, 2010, pp. 291-292). In general, the aim of the comparative method is to develop or test theories by examining the similarities or differences between two or more cases. Therefore, this method is “a case oriented strategy of comparative research” (Ragin, 1989, p. 16).

¹⁶ Marsh and Stoker (2010, pp. 294-305) discuss the strengths and weaknesses of large Ns vs. small Ns. They demonstrate how small Ns researchers addressed different issues associated with qualitative research including generalizability issues and case selection bias.

Considering the time and resource constraints, two government organisations are selected as cases for this study and the “most similar systems” design research approach is employed as a research strategy. As with any case selection methodology in qualitative research, the most similar system design has its own shortcomings such as the “problems of non-representativeness” (Gerring, 2006, p. 139). Indeed, this research uses the most similar system design as proposed by Lijphart (1971) only to inform the initial case selection and guide research analysis with acknowledgment of its weaknesses.

Using a comparative method, this study examines empirical evidence to determine whether there is likely to be causality in the relationship between internal control and corruption. Admittedly, taking the causal view is very difficult, yet researchers usually keep an eye out for any constant pattern between independent and dependent variables or vice versa. A ‘process tracing’ technique is employed for this purpose to “avoid mistaking a spurious correlation for a causal association” (Mahoney, 2003, p. 363). Under this technique, the researcher works like a “detective” to filter and connect relevant empirical evidence to a proposed hypothesis (Gerring, 2007, p. 173). Typically, the investigator starts with a good description or a timeline of the sequence of events. From here the causal principles contained within the description can be explored with a view to confirming or negating these ideas, and determining which tests are appropriate for appraising the evidence (Collier, 2011).

In the context of this research, and according to the rational choice school of thought, it is to some extent simple to determine the causal mechanisms between internal control and corruption. In essence, internal control increases the costs of corruption, leading rational individuals to refrain from wrongdoing if they find the costs exceed the benefits of corruption. Further, the inference of causality would be supported if the researcher discovers that, all things being equal, corruption is primarily determined by how effective internal control is in government organisations. In other words, all rival hypotheses, such as a higher salary scale leads to a lower level of corruption, should be ruled out by identifying and incorporating them into the research design. The researcher also asked interviewees to demonstrate with examples how internal control leads to a lower level of corruption, or vice versa.

1.5.4 Case Selection

Since the most similar systems design is employed as a research strategy, the researcher selected and examined only cases with the most similar features (i.e. variables). These features were held constant in order to identify dissimilarity between cases and adduce any potential causes of difference between concerned variables (Lijphart, 1971; Marsh & Stoker, 2010).

Three stages were defined for selecting the most appropriate sample for this research. The first one was to review the literature in general to identify factors or variables that influence the level of corruption. The second stage was to categorise or label these factors into either “societal factors” or “organisational factors.” The third stage was to keep these factors constant or under control when selecting the sample for this study.

Stage One:

There are lots of possible explanations for corrupt behaviour. However, after reviewing the literature, the following factors were identified as those which are most important in influencing the levels of corruption:

1. Religion, historical background, level of economic development, openness to trade, the government structure, and type of political systems: the effects of all these factors on corruption were investigated by Treisman (2000). He found that countries with a protestant culture, British heritage, advanced economies, unitary state system, higher exposure to imports, or long exposure to democracy are, all things being equal, least corrupt. His findings have been contested as they cover very broad topics that cover pretty much everything that states do or are (see A. Ades & Di Tella, 1999; Raymond Fisman & Gatti, 2002; Goel & Nelson, 2005; Rose-Ackerman, 2007; Seligson, 2002; Weyland, 1998).
2. Natural resources: recent empirical research suggests that countries with natural resources are exposed to higher corruption risk (Ploeg, 2011; Vicente, 2010).
3. Legal system: Graeff and Mehlkop (2003) emphasise the role of legal structure and rule of law on curing or spreading corruption in different countries. For

instance, enacting and enforcing an access to information act can reduce the level of corruption significantly (DiRienzo, Das, Cort, & Burbridge, 2007).

4. Economic systems and policies: Gerring and Thacker (2005); and Rousso and Steves (2007) argue that countries with neoliberal economic policies are perceived to be less corrupt than those with planned economic policies.
5. Government structures: Fan, Lin, and Treisman (2009) found that more government tiers are often associated with an increased level of corruption.
6. Salary scale: several scholars discuss the effects of wages on bureaucratic corruption. Many of them suggest that a higher salary scale could discourage public officials from being corrupt. As rational actors, officials would be more hesitant to abuse their positions when their salaries are high because of negative consequences associated with losing their jobs (Rose-Ackerman, 1999, pp. 45-72; Rose-Ackerman & Palifka, 2016; Søreide & Rose-Ackerman, 2006, pp. 68-73; Van Rijckeghem & Weder, 2001).
7. Job security: Rose-Ackerman (2007, p. 497) asserts that job insecurity increases the level of corruption as officials attempt to enrich themselves before getting fired.
8. Employment of women: Dollar et al. (2001); and Goetz (2007) affirm that the higher the employment of women in the public sector, the lower the level of corruption.
9. Risky business: Quah (2001) highlights that customs, taxation, traffic police, and immigration are more vulnerable to corruption than any other government organisations. Taking into consideration the nature of their activities, officials' discretion in these department is high because in many circumstances the law enables officials to exercise their professional judgement to assess fines, customs or taxations on a case by case basis.
10. State ownership: several studies suggest that full or partial privatisation of government activities could increase efficiency and minimize bureaucratic corruption, especially embezzlement (Boycko & Shleifer, 1996).

11. Competition: through competition bribe solicitation could be reduced because officials “have less to sell in exchange for bribes” (Rose-Ackerman, 2007, p. 8).
12. Officials’ discretion: bureaucratic corruption is more likely to increase when “officials have broad discretion to make case-by-case determinations” (Rose-Ackerman, 1978, p. 175).

Even though some of these factors, such as salary scales and types of political system, have been under intense debate in the corruption literature¹⁷, this research attempts to consider all these factors in the research design and case selection process¹⁸. This enhances the trustworthiness of the research findings.

Stage Two:

This study analyses corruption factors on two levels. The first is factors related to particular countries, regions or cultures. These are labelled “societal factors” and include: religion, historical background, level of economic development, openness to trade, government structure and type of political systems, geographical area, legal system, government structures, economic systems, and policies.

The second level includes factors that influence the level of corruption in bureaucratic government organisations. These include: salary scale, job security, employment of women, complexity of business, state ownership, competition, and officials’ discretion.

Stage Three:

The third stage involved selecting the research sample. In order to keep the “societal factors” constant, all cases were selected within one country (i.e. Saudi Arabia), so they were all examined within the same culture and under the same political, legal, and economic systems. This is because comparing two government institutions in two

¹⁷ For the literature review on anti-corruption measures such as salary scale, refer to Chapter Two.

¹⁸ The research only considers ‘known’ variables that are discussed in the corruption literature and have empirical evidence to support them. Obviously, there are a lot of potential variables that do not have empirical evidence and there is no way that all of them can find their way into my analytical approach.

different countries is less meaningful as, for instance, the judiciary or police plays a role in tackling institutional corruption. Therefore, corruption could be less in one government institution in comparison to another government institution in a different country, not because of internal control, but because of powerful law enforcement and criminal justice system.

However, the most challenging task was to select cases within Saudi Arabia with the same level of salary, job security, employment of women, business risks, state ownership, competition, and officials' discretion.

The initial plan for this research was to select two government agencies and two state enterprises as units of analysis. However, after scrutinising all state enterprises, the researcher was not able to find two cases with similar levels of competition, salary scale, and complexity of business. Therefore, the researcher decided to select two government funds¹⁹ in Saudi Arabia as the research sample.

In line with University of Sussex ethical review guideline, and for the purpose of maintaining the anonymity of individuals and institutions participating in this study, the funds were given the fictitious names "Fund A" and "Fund B."

Although the two funds were established for different purposes, their main activities are the same. Both provide interest-free medium- and long-term loans to support companies working in the Saudi manufacturing industry or agricultural business. As illustrated in Table (1.4), both have their own salary scales, which are higher than civil servants' salaries. Competition is low for two reasons. First, there are several government and non-government organisations that provide interest-free loans in Saudi Arabia, such as Saudi Credit and Saving Bank and the Centennial Fund, yet these organisations are not as big as Fund A or Fund B. Second, although banks provide loans with interest, they still have the competitive advantage as some business people cannot wait several months to get loans from these funds, so they go to the banking sector to fulfil their financial needs.

¹⁹ A government fund is not a term with which many people in the UK are familiar, but essentially it is the way in which the government invests its funds in a particular (and usually important) sector of the economy in order to boost production where leaving the funding to the free market might result in a lower level of economic activity. In essence they are supposed to provide short-term subsidies to industry for long term economic gain.

As well as having different purposes, there are other differences between the two funds. Fund B is scattered more geographically, they serve larger and different types of clients and are more focussed on rural development rather than just maximising economic returns. Therefore, to some extent the two funds face different types of risk, and should, at least theoretically, have different attitudes to risk.

Table 1.1

Case sample for this study

| Case | Independent variables | | | | | | | | Dependent variable |
|--------|-----------------------|--------------|--------------|---------------------|-----------------|-------------|---------------|-----------------------|--------------------|
| | Internal Control | Salary Scale | Job Security | Employment of women | State ownership | Competition | Level of risk | Officials' discretion | Corruption |
| Fund A | ? | Medium | High | None | Full | Low | Medium | Medium | Low |
| Fund B | ? | Medium | High | None | Full | Low | Medium | Medium | Medium |

The dependent variable for this study is the level of corruption. It is derived from the Saudi Corruption Index. Fund A is ranked as the least corrupt among 37 government organisations in the index whereas Fund B is the most corrupt fund in Saudi Arabia, but it is still perceived with a medium level of corruption in comparison with all government organisations. In line with Transparency International CPI, the Saudi Index

rates government organisations on a scale of 0 (highly corrupt) to 100 (very clean). The following table shows how government organisations are rated:

Table 1.2

Different Categories of Corruption

| Rating | Scores | Number of organisations |
|----------------|---------------|--------------------------------|
| Least corrupt | 50-100 | 10 |
| Medium | 43.6-49.6 | 16 |
| Highly corrupt | 0-43.5 | 11 |

It should be noted that the Saudi Index rated all government organisations between 59 and 40 with average score of 47. Fund A and Fund B were rated as 58.324 and 46.458 respectively.

1.5.5 Data Sources

The main data collection sources for this study were the Saudi Corruption Index, semi-structured interviews, observations, and document analysis. The Saudi Corruption Index was employed to measure corruption while in-depth semi-structured interviews, observations, and document analysis were used to analyse and evaluate the quality of internal control in government organisations.

Since Article 14 of the Saudi Internal Audit Regulations lays the responsibility of evaluating the effectiveness of internal control on internal auditors, interviews were mostly conducted with internal auditors from each government organisation.

The research conducted 57 interviews as follows:

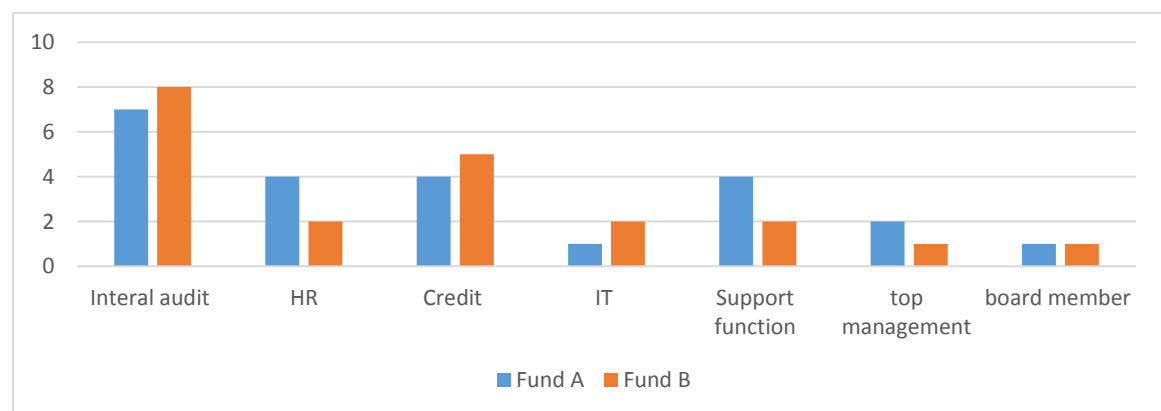
Twenty-three respondents within Fund A consisting of seven officials from the internal audit, four from the HR department, four from the credit department, one IT manager, four officials from the support functions, two from top management, and one board member.

Twenty-one respondents within Fund B consisting of eight officials from the internal audit, two from the HR department, five from the credit department, two IT managers, two officials from the support functions, one from top management, and one board member.

Thirteen respondents from outside the two funds consisting of five government auditors, three commercial external auditors, three consultants for fund applicants, and two loan applicants.

The following figure summarises interviewees' positions in both funds.

Figure 1.3
Interviewees' Positions



Source: own design

Then, the researcher validated the outcomes of these meetings with documentary analysis and interviews with senior management and external auditors (i.e. triangulation). The documentary analysis included but was not limited to studying the code of ethics, the risk assessment manual and plans, organisational structures, job descriptions, internal auditor reports, recruitment policy, and authority matrix.

The process of structuring interview questions and document analysis was guided by the updated edition of the COSO Internal Control Framework (2013). As explained in

Chapter Two, this framework facilitates the evaluation of the effectiveness of internal control in government organisations. In accordance with the COSO framework (2013, p.18), an effective internal control means that each of the following “components and relevant principles is present and functioning and components are operating together.” So every internal auditor was asked to comment on the following statements:

Table 1.3
The Main Elements of the COSO Internal Control–Integrated Framework (2013)

| | | |
|---|---|---|
| 1 | Control Environment (5 Principles) | The organization demonstrates a commitment to integrity and ethical values. |
| | | The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control. |
| | | Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives. |
| | | The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives. |
| | | The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives. |
| 2 | Risk Assessment (4 Principles) | The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives |
| | | The organization identifies risks to the achievement of its objectives across the entity and analyses risks as a basis for determining how the risks should be managed. |
| | | The organization considers the potential for fraud in assessing risks to the achievement of objectives. |
| | | The organization identifies and assesses changes that could significantly impact the system of internal control. |
| 3 | Control Activities (3 Principles) | The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels. |
| | | The organization selects and develops general control activities over technology to support the achievement of objectives. |
| | | The organization deploys control activities through policies that establish what is expected and procedures that put policies into action. |
| 4 | Information & Communication (3 Principles) | The organization obtains or generates and uses relevant, quality information to support the functioning of internal control. |
| | | The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control. |
| | | The organization communicates with external parties regarding matters affecting the functioning of internal control. |
| 5 | Monitoring Activities (2 Principles) | The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning. |
| | | The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate. |

Source: Developed Based on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013) Internal Control-Integrated Framework.

It is important to note that the COSO framework identifies certain characteristics for each principle. This enhances the objectivity and accuracy of internal control evaluation. For instance, for principle (1) “The organisation demonstrates a commitment to integrity and ethical values”, COSO introduces the following characteristics: (a) sets the tone at the top; (b) establishes standards of conduct; (c) evaluates adherence to standards of conduct; (d) addresses deviations in a timely manner.

Although semi-structured interview questions were derived from the COSO framework, further questions based on actual practice were to uncover any unexpected or hidden factor not adequately covered by my theoretical approach.

After data collection, all interviews were transcribed, analysed, and then coded and synthesised to search for any trend or patterns between internal control and corruption in government organisations.

1.5.6 Coding

There are alternative approaches for coding (sometimes called indexing, labelling, or categorisation) qualitative data. However, the most prominent one in this area is the approach of Corbin and Strauss (2015) in which they developed three stages to analyse qualitative data, namely “open coding”, “axial coding”, and “selective coding”²⁰.

This research used insights from Corbin and Strauss as well as other approaches such as Alan Bryman (2012) to develop its own seven stages of analysing data as follows:

The first stage was to read through *all transcripts in general*, paying extra attention to key notes and findings that the researcher wrote immediately after each interview. Such notes usually highlighted not only personal observations during and after each interview, such as the extent to which the interviewee was knowledgeable, experienced, open minded, frank, transparent and willing to support his argument with solid

²⁰ Basically, ‘open data’ involves reading transcripts and attaching names to each passage, ‘axial coding’ entails both finding interconnections between codes and grouping similar codes, and ‘selective coding’ identifies the key codes that cover all relevant data.

examples or official documents, but also first impressions of how relevant and useful the interview was in answering the main research question.

The second stage was to divide my transcripts into three groups: the first and second groups cover Fund A and Fund B respectively. The third group includes transcripts for interviewees who are knowledgeable in internal control practices for both funds such as the government external auditors.

The third stage was to read Fund A transcripts in depth with the aim of systematically categorising each passage (or sometimes a sentence) into the five main dimensions and 17 principles of the COSO Internal Control Framework. This stage was simplified because the interview questions were constructed based on the five main components of the COSO framework. The same process was followed when analysing Fund B interviews.

The fourth stage was to read through passages that were not linked to the COSO internal control framework (in stage three), but which could still explain the different levels of corruption in both funds. During this stage, the researcher introduced new themes to cover these pieces of data, such as historical background and trust. This stage was also facilitated by the way in which interview questions were developed (i.e. each interviewee was given the opportunity to comment on the effectiveness of internal control in tackling corruption in comparison with other anti-corruption mechanisms, such as increasing salary scale, employment of women, and privatisation).

The fifth stage was to revise previous codes for simplicity's sake. This included redefining the five dimensions of the COSO framework into the following three components: soft control (known as control environment in the COSO framework), hard control (which includes risk assessment, control activities under the COSO framework) and monitoring control.

The sixth stage was to use three highlighter pens (red, green, and yellow) to differentiate between important and non-important data. Important data includes previous corruption cases, surprising or unusual findings that are consistent or inconsistent with the corruption literature, figures to support interviewees' arguments, the results of analysing crucial official documents, and key statements from interviewees that were very well articulated to explain or demonstrate the extent to which internal control is

effective or ineffective in tackling corruption. This stage helped in identifying central driving concepts that influence the levels of corruption in both government funds within or outside the COSO framework

The seventh stage was to relate the coding to the main research question, theoretical framework, hypotheses, and the literature in general. As shown throughout the empirical chapters, the research employed figures to connect between coding and theoretical frameworks.

1.5.7 Trustworthiness

The quality of qualitative research depends mainly on the trustworthiness of data collection methods and analysis. As discussed by Lincoln and Guba (1985), Lietz, Langer, and Furman (2006), Alan. Bryman and Bell (2011) and Creswell (2013), trustworthiness can be established by considering the following four criteria: credibility, dependability, conformability, and transferability.

Credibility refers to the extent to which the findings of qualitative research are valid and reflect the real picture of the phenomenon under study. Credibility and the legitimacy of qualitative research have traditionally been at the centre of debate between quantitative and qualitative researchers. Maxwell (1992, p. 279) summarises this debate quite well. He highlights that the absence of reliable and standardised measurements to control the qualitative researcher's bias and subjectivity represents the main criticism of qualitative research²¹. In line with Thompson and Panacek's (1998, p. 70) recommendation, this research does not replicate the debate of how qualitative methods meet the standards of quantitative research, instead it focuses on "the unique knowledge stemming from the study in a manner that enhances understanding and practice."

In comparison with quantitative research, dependability, confirmability and transferability are analogous to reliability, objectivity and generalizability respectively. Dependability and confirmability are achieved when the research findings are verifiable

²¹ Maxwell (1992) differentiates between descriptive validity, interpretive validity, theoretical validity, generalizability, and evaluative validity. Refer to this author for further discussion of these categories.

and auditable. Generalizability refers to the extent to which the research findings fit into others contexts (Denzin & Lincoln, 2011; Lincoln & Guba, 1985).

To maximise dependability, confirmability and credibility in the data collection and analysis, this research adopts the following strategies. First, it triangulates interview and documentary data from multiple data sources, from multiple contexts, and across multiple informants. As explained previously, interviews were conducted with internal auditors from two different organisations. Then, the outcomes of these interviews were validated with documentary analysis and interviews with external auditors, managers, and staff. Triangulation is considered a powerful tool in maximising the validity of research findings because it includes cross checking information from different sources (Denzin, 2009; Lincoln & Guba, 1985).

Secondly, this study utilises the COSO Internal Control Framework to evaluate the quality of internal control. The usage of this leading and most globally recognised internal framework enhances the credibility of this research (D'Aquila, 2013). Furthermore, it increases the confirmability and dependability of the study because COSO framework clearly specifies the criteria for evaluating the effectiveness of internal control. So any researcher can use the same criteria to come up with similar findings.

Thirdly, this study strictly adheres to the University of Sussex Ethical Review Guideline, which includes the following:

1. Assuring interviewees that all information collected during the study would be solely for research purposes and kept strictly confidential. Therefore, they will suffer no consequence from being honest and transparent with the researcher.
2. Highlighting to all participants of this study the importance of being precise and accurate not only to benefit Saudi Arabia but also to enrich the literature on corruption prevention mechanisms.
3. Asking interviewees to review, refine, and approve interview transcripts to ensure their accuracy and precision. This step was taken at the end of each

meeting or via email. If interviewees preferred to approve the transcripts via email, I asked them provide me with their emails in the consent forms²².

4. Explaining to all participants their right to withdraw from the interviews at any time without any justification.

More specifically, the researcher spent approximately three to five minutes at the beginning of each interview to build trust with respondents by being transparent with the following information: “Who I am”, “what the nature of my research is”, “how the data will be used”, “where the results will be disseminated” and “whether the information will be attributed or anonymous” (Harvey, 2011, p. 433).

The fourth and final strategy to enhance the trustworthiness of this research was to ensure that the analysis of all recorded interviews, transcripts and documents was very well organised and documented. This ensured that an audit trail would be available and easily accessible in case anyone needs to review how the researcher concluded his findings.

With regard to transferability, the literature is rich with discussions and debate on how to generalise qualitative findings based on a single or limited number of cases. In general, advocates of qualitative research argue that the number of cases is irrelevant. In order to have a generalizable knowledge, one has to be more focused on the quality of case selection and the appropriateness of the theoretical framework. As explained by Flick (2014, p. 34) “Relevant questions here are ‘which cases?’ rather than ‘how many?’ and ‘what do the cases represent or what were they selected for?’”

To address the generalisability issue, all cases for this study were selected based on theories. As discussed previously, factors that influence the level of corruption were identified from the corruption literature; they were then categorised into either society-specific factors or bureaucratic organisations’ factors. The thesis attempts to keep all these known factors constant, or under control, when examining the relationship between internal control and corruption. Thus, the outcomes of this research should be at least theoretically applicable to other countries, especially when applying the same

²² Refer to the appendices for interview questions, consent forms and information sheet for participants.

research methodology. It should be noted that selecting all cases within one country is very important to keep all “societal factors” constant.

Besides careful selection of cases, additional measures were taken to enhance the generalisability of this research, including the employment of the principal-agent model as a theoretical framework and the selection of the COSO Internal Control Framework to assess the effectiveness of internal control. As mentioned earlier, COSO internal control is considered a global framework and implemented in most countries (D'Aquila, 2013). Consequently, the findings of this thesis should apply, at least theoretically, to any country where that framework is implemented. Furthermore, COSO determines a set of principles to evaluate the effectiveness of internal control. These standardised principles facilitate comparison between the findings of this study and any other potential internal control research in other countries.

Chapter 2

Literature Review of Anti-Corruption and Internal Control

2.1 INTRODUCTION

With the introduction of the United Nations Conventions against Corruption (UNCAC) in 2003, more corruption research started to emerge from different disciplines. However, most of this research was conducted at a national or societal level using international corruption indices, with little corruption research being conducted at the organisational or institutional level. This could be attributed to the difficulties associated with gaining access to government institutions to examine this sensitive topic. Luckily, the researcher was able to overcome this challenge after conducting a pilot study in which several government institutions, who showed no interest or willingness to participate in this project, were filtered out.

After extensive use of many research engines, such as Google Scholar, ProQuest, Elsevier Science Direct, and Scopus, no research was found that examines the relationship between the COSO Internal Control Framework and corruption in the public sector²³. However, some of the research examines some elements of COSO internal control, such as recruitment, external audit and accountability. These elements are usually recognised as institutional factors or incentives (rather than internal control) to tackle corruption. Most of this body of research can be divided into three groups. The first and predominant group falls into what Johnsen, Taxell, and Zaum (2012, p. 11) call “grey” corruption literature, such as working papers or research with significant weaknesses in their methodologies. The second group of research, which examines the impact of different types of institutional factors on corruption, is largely theoretical, with weak empirical foundations. The third group of research focuses on analysing corruption in the private sector, mostly listed companies. Therefore, this thesis offers a significant contribution to both the accounting literature, and the corruption literature,

²³ As discussed in section 2.2.4, it was only in 2015 that more research on the impact of internal control (in general) on corruption started to emerge.

by examining the effectiveness of the COSO accounting internal control in tackling corruption with a strong methodological and theoretical approach.

The main objective of this chapter is to provide a literature review of anti-corruption measures and internal control, with particular focus on anti-corruption measures that target institutional corruption. The chapter starts with alternative definitions of corruption from different perspectives, namely legality, public opinion, and public interest. Then, it discusses methodological challenges of measuring corruption. Following on from that, it provides an overview of how corruption has been analysed and tackled by different schools of thought.

The second half of this chapter provides a literature review of internal control, covering its development and usage, an overview of existing frameworks, its application in the public sector, the evaluation of its quality, and a discussion of its limitations.

2.2 LITERATURE REVIEW OF ANTI-CORRUPTION

2.2.1 Definition of Corruption

Although corruption is present in both private and public sector organisations, the main focus of scholarly interest has been on the corruption of public officials (Monteduro et al., 2016). There is still no definitive definition of public corruption that could be applied across countries and societies. In fact, what is considered corruption in one country could be considered as a routine way of doing business, or a gift, in another country (Dimant & Schulte, 2016; Hough, 2013; Kaufmann & Vicente, 2011). However, many political science and public administration scholars such as Peters and Welch (1978) and (Scott, 1972) offer three different criteria for defining when a public official acts corruptly from legal, public opinion, and public interest perspectives.

From a legal standpoint, corruption is mostly limited to public officials' behaviour in acting in their self-interest (to gain personal wealth or status) *in violation of their formal duties*, including violation to relevant rules governing their work (Sandholtz & Koetzle, 2000). Although the legal approach offers a clear definition of what is corruption and what is not for most cases, it is not broad enough to cover many corrupt activities from both the public opinion and public interest perspectives (Monteduro et al., 2016). This

can be clearly seen in the recent expenses scandal in the UK parliament in which MPs claimed expenses for household improvement, including maintaining a moat around an MP's mansion. Although claiming these expenses was not in fact illegal, public opinion deemed these practices to be corrupt, forcing a number of MPs to stand down from their positions (Pattie & Johnston, 2012). This leads to the second and third definitions of corruption from public opinion, and public interest viewpoints respectively.

From a public opinion perspective, corruption is defined as any act where the public “determines it to be so” (Monteduro et al., 2016, p. 35). This school of thought considers that there is no clear cut definition of corruption that could be applied across all countries as each country (or even part of a country) has its own culture and social norms. Thus, this approach seems to challenge the idea of enforcing one definition of corruption across different countries²⁴. Also, this approach recognises that there could be a significant difference between what is illegal as defined by law, and what most citizens consider to be corruption (Dimant & Schulte, 2016). However, one major drawback of this approach is the failure to clarify the definition of public interest and who represents it (Dimant & Schulte, 2016; Scott, 1972).

The same could be said for the public interest approach. Corruption is any act that violates the public interest regardless of what the law dictates. However, basing the definition of corruption on the public interest seems to make the boundary of what is or is not corruption so blurred as to render it impossible “to identify an objective public interest” for a large proportion of the population (Sandholtz & Koetzle, 2000, p. 34).

In the context of this research, and as explained in section III, corruption is understood as “the abuse of entrusted power for private gain” (Transparency International, 2013). This definition is globally recognised by several international organisations including the World Bank and Transparency International (OECD, 2013).

²⁴ This could explain why international conventions such as the United Nations Against corruption did not introduce a definition of corruption.

2.2.2 Measuring Corruption

There are two main challenges in measuring corruption: the first is the fact that corruption, by its very nature, is not usually carried out overtly, which makes its measurement difficult; the second is the lack of agreement in the methodology used to accurately measure corruption, which is also linked to differing perceptions of what corrupt behaviour actually is across different cultures (Dimant, 2013; Dimant & Schulte, 2016).

In the corruption literature, there are two widely used corruption indices: Transparency International's Corruption Perception Index (CPI), and the World Bank's Control of Corruption Index (CCI). These two indices are seen by researchers as valid and reliable sources for measuring corruption, and the correlation between the two of them is 0.97 (Svensson, 2005).

The reason for this high correlation between the two indices is that they use similar sources of information, but the CPI filters out some sources of information based on pre-set criteria, such as that the source must cover a certain number of countries. While the CPI takes an average score for each country, the World Bank's CCI takes the raw data, and applies its own matrix to weight the data, lending less weight to outliers that are way above or below a country's average²⁵.

Both of these indices have the same deficiency – namely that they measure the perception of corruption, rather than corruption itself. This indeed may mean that both indices are “actually (and inadvertently) distorting reality, simply reinforcing stereotypes and cliches” (Hough, 2016).

Therefore, there is an increasing tendency by researchers, including researchers at Transparency International, to survey the experience of corruption, rather than its perception, in order to measure the level of corruption. For example, Transparency International now publish their Global Corruption Barometer, which is based on respondents' experience of corruption. However, with this the experience of corruption

²⁵ This paragraph and the subsequent one are based on personal analysis of the Corruption Perception Index, and the World Bank's Control of Corruption Index. The author also visited Transparency International in Berlin and The World Bank in Washington, D.C. to discuss these indices. Some common sources of Transparency International and The World Bank were visited such as Bertelsmann in Germany, the Economist and IHS in the UK, IMD and the World Economic Forum in Switzerland, and the World Justice Project and the Political Risk Service in the US.

as a genuine measurement of corruption is still debatable as it does not necessarily measure the actual level of corruption. What makes things more complicated is that an increasing amount of research demonstrates that experience of corruption indices gives a completely different outcome than perception-based indices. For instance, Weber's (2008) comparison of the Global Corruption Barometer and Corruption Perception Index reveal that:

The disparities between opinions and experience follow no common pattern from country to country...[and] the "distance" between opinions and experiences vary haphazardly from country to country and therefore perceptions-based comparisons between countries cannot be linked to differences in the underlying material conditions.

Heywood and Rose (2014) reinforce (Weber, 2008)'s findings by showing not only how perception and experience of corruption largely vary but also that they are not reflective of real levels of corruption as they ignore important factors such as the reported number of corruption cases, including whistle-blower cases, and prosecuted, and convicted corrupt officials. They support their argument by showing how the findings of 'perception' and 'experience' of corruption research do not fully correspond with the findings of research on the same subject but follow different corruption measurement approaches such as mathematical, inspection, and estimation methods. For instance, Olken (2009) examines corruption in road building projects in 608 Indonesian villages. He compares *how much money was paid* into these projects as per government public reports and *how much money should have been paid* using independent estimates from suppliers, engineers and labours. The difference is considered to be a proxy of corruption, which is then compared to the Indonesian perception of corruption. The result of this research shows that there is a "weak" correlation between the perception of corruption and the research's non-perceptual measurement of corruption (Olken, 2009, p. 963).

Despite these deficiencies, the use of perception-based indices is still useful as individuals make decisions based on perceptions and experience, regardless of whether those perceptions are correct, and those experiences are representative of a country's actual level of corruption (OECD, 2013).

Based on the above rationale, the usage of the Saudi Corruption Index is justified as a good proxy to measure the level of corruption in government organisations, as it measures both the perception and experience of corruption to rate each institution.

2.2.3 Anti-corruption Reforms

Anti-corruption reforms can be analysed from a number of different angles. One angle is to look at the underlying factors of corruption. In essence and as discussed previously in Chapter One, there are two ways of looking at this approach. The first way is to introduce anti-corruption measures based on the institutional economic framework, which deals with corruption as a principal-agent problem. In practice, the vast majority of anti-corruption interventions fall into this camp. The second way is to propose anti-corruption reforms based on neo-institutionalism ideas, which deals with corruption as a collective action problem. Further analysis of both of these camps were discussed previously in section 1.2.

Another angle of looking at anti-corruption reforms is to differentiate between ‘external controls’ and ‘internal controls’ of corruption within government institutions. In this thesis, internal control is evaluated by the COSO Internal Control Framework. External control includes any factors that influence the levels of institutional corruption as a result of external forces, such as public opinion and judicial/legal controls.

The following section provides an overview of the anti-corruption measures as discussed in the corruption literature.

2.2.3.1 Establishment of anti-corruption agencies

A recent article by Kuris (2015) examines the effectiveness of anti-corruption commissions in tackling corruption. Drawing lessons from more than ten countries, Kuris (2015, p. 125) distinguishes between what he calls “watchdog” and “guard dog” anti-corruption agencies. Basically, guard dog agencies have a stronger mandate and financial support than watchdog agencies; thus, they are usually better utilised in less corrupt countries where government institutions are well established and rule of law is

strong. The author argues that these two types of agency are not sufficient by themselves to tackle corruption. Instead, they should be considered within a wide range of anti-corruption initiatives, depending on the entrenched nature of corruption, and the availability of public resources to support the operation of anti-corruption agencies.

2.2.3.2 Development of anti-corruption policies and strategies

The impact of governments' interventions with anti-corruption policies and strategies have been disputed. While some research attempts to demonstrate the effectiveness of these interventions in curbing corruption (e.g. Man-wai, 2005), the vast majority of research shows that merely introducing anti-corruption policies and strategies is largely ineffective unless they are coupled with genuine political will and strong monitoring mechanisms (e.g. Hamilton-Hart, 2001). It also appears that the degree of successful implementation of anti-corruption policies is wholly dependent on the political and economic environment in which they operate (Johnsøn et al., 2012).

2.2.3.3 Increasing salaries

Probably one of the most common anti-corruption policies discussed in the bureaucratic corruption literature is raising the salaries of public servants. It is argued that such a policy would raise the cost of corruption as public officials would risk a well-paid job should they choose to engage in corrupt practices (Rose-Ackerman & Palifka, 2016; Rose-Ackerman & Truex, 2012; Van Rijckeghem & Weder, 2001). This argument is supported by several empirical studies in both developed and developing countries such as Lindbeck's (1998) research in Sweden (as cited in Dimant, 2013), and Noor's (2009) research in Pakistan.

In contrast, research from Kenya, Peru, and Argentina reveals that merely increasing salaries without supplementing it with other anti-corruption mechanisms has no or sometimes negative effects on corruption in these countries (Dimant, 2013; Ray Fisman & Miguel, 2010). This can be clearly seen in countries where small changes to wages levels are introduced (Rose-Ackerman & Truex, 2012) or where public servants are already better paid than their private sector counterparts (Filmer & Lindauer, 2001).

Indeed, there are obvious administrative and economic difficulties in employing higher salaries scales as an anti-corruption tool. For a start, it is hard to determine the *right* levels of salary scales for public servants as living expenses largely vary not only from country to country but also within a county or city. Consequently, salary increase might result in governments paying too much for their officials, increasing inflation and wasting taxpayers' money. Furthermore, salary increase is more likely to deal with the "need" type of corruption rather than the "greed" type of corruption (Bauhr, 2012, p. 68; Noor, 2009, p. 37).

Another important factor which can result from paying public sector workers higher wages than workers in the private sector is that this introduces corruption to the recruitment process. Applicants wanting higher paid public sector positions can pay recruiters or managers to obtain their positions (Patrinos & Kagia, 2007).

2.2.3.4 Meritocratic recruitment practices

Having a recruitment process that tolerates nepotism and other types of influence, rather than selection on merit, can attract applicants who seek out public sector jobs in order to manoeuvre themselves into a position where they can solicit bribes or embezzle assets. In other words, a corrupt recruitment system is more likely to increase the overall level of bureaucratic corruption, and vice versa. This is supported by a number of studies. For instance, Dahlström, Lapuente, and Teorell's (2009) analysis of 520 surveys from 52 countries shows that there is a strong correlation between a meritocratic recruitment process and clean or less corrupt countries.

There are a number of suggested reforms to combat this, such as a transparent recruitment process, the public advertising of job vacancies, and a thorough audit of recruitment practices (Rose-Ackerman & Truex, 2012).

2.2.3.5 Staff rotation

As corrupt behaviour often necessitates the involvement of more than one person, the longer a government official remains in the same position, the greater the opportunities

to form potentially corrupt relationships. To prevent this, many organisations, such as the German Federal Government, adopt a staff rotation policy. Abbink's (2004) experiment in Germany argues that staff rotation significantly reduces bribery in the public sector.

However, there is a serious potential downside to this practice, in that corrupt management can use the threat of rotation to positions of little influence in rural areas as a mechanism to repress would-be whistle-blowers from exposing corrupt practices (Rose-Ackerman & Palifka, 2016; Rose-Ackerman & Truex, 2012).

2.2.3.6 Institutional integrity

Having the right institutional integrity is essential for any successful anti-corruption reforms. Previous research shows alternative ways to achieve this. One way is to have a very well-articulated code of ethics that are addressed and inspired by not only organisational staff but also senior management (Monteduro et al., 2016).

Having a code of conduct is considered important to maintain institutional integrity, and such codes should be not only addressed to all staff but also it must be inspired by senior management (Larmour & Wolanin, 2013). Otherwise, as demonstrated by Kaptein and Schwartz (2008) merely having a code of ethics does not seem to influence the levels of institutional integrity. Furthermore, as discussed by García-Sánchez, Frías Aceituno, and Rodríguez Domínguez (2015) using a sample of 760 listed companies from 12 developed countries, having an independent board can promote institutional integrity and reduce the likelihood of corrupt practices as these board members are less likely to have any conflict of interest and at the same time are not willing to jeopardise their reputation.

Finally, Greenlee, Fischer, Gordon, and Keating's (2007) analysis of 58 fraud cases in non-profit organisations, with a total loss of nearly USD 30 million, reveals that conflict of interest is the most common form of corruption, followed by bribery. Yet, "the largest corruption losses appeared in cases of improper gifts" (Greenlee et al., 2007, p. 687). Their investigation also discloses that 95 percent of asset misappropriation was related mostly to stolen cash and paying illegitimate expenses. The authors conclude

that control environment was very critical in preventing or facilitating corruption as most non-profit organisations “operate in an atmosphere of trust” (Greenlee et al., 2007, p. 690). Corruption cases are usually present in organisations with weak checks and balances as well as less powerful monitoring bodies. Therefore, this stresses the importance of having an independent, knowledgeable, and powerful board of directors which sets the expectation of everyone in their organisations, acts upon them, and holds everyone accountable to them. This indeed would shape institutional integrity of non-profit organisations where corrupt practices are minimised (Greenlee et al., 2007).

2.2.3.7 External audit

There is logic to the argument that increasing monitoring and auditing, and therefore increasing the likelihood of being caught, reduces the level of corruption. Olken’s (2007) study of an Indonesian road building project shows that when 100 per cent of villages involved in the project were audited by the central government audit agency (compared with the baseline of 4 per cent that was the level prior to this study) the level of missing expenditure was reduced by 8 per cent. This study also contrasts top down monitoring with bottom up monitoring of the same road building programme, which shows that increasing the levels of bottom-up monitoring had little impact on reducing the level of missing funds. However, this finding is not consistent with much recent research that argues that bottom up anti-corruption reforms are the way forward for countries with endemic corruption (e.g. Hopkin, 2002; Hough, 2013).

2.2.3.8 Accountability and Law enforcement

Studies examining the relationship between the level of punishment and the level of corruption have found greater difficulty in establishing whether such a link exists (Rose-Ackerman & Truex, 2012). Abbink, Irlenbusch, and Renner’s (2002) laboratory experiment shows some evidence that if the threat of punishment is higher, rational actors are less likely to engage in corruption. This research is supported by Greenlee et al.’s (2007) analysis of 58 fraud cases in non-profit organisations in which they show how charitable organisations are more vulnerable to corruption because of weak accountability.

Also, previous research has argued that showing leniency to those giving a bribe, but more severely punishing those who accept it could increase the likelihood that harassment bribes would be reported to the authorities as these corruption reports would be taken seriously (Dufwenberg & Spagnolo, 2015); however, at the same time it could increase the supply side of corruption (Engel, Goerg, & Yu, 2013).

2.2.3.9 Transparency

Where there is a tradition of publicising the processes of government in the media and on-line, there is a greater level of citizens observing corrupt behaviour and holding public officials to account, either by whistle blowing to law enforcement, complaints to the media or more senior government officials, or voting out corrupt elected officials (Rose-Ackerman & Truex, 2012).

There is increasing evidence that initiatives to increase transparency can benefit societies where corruption is considered endemic (Papyrakis, Rieger, & Gilberthorpe, 2016; Rose-Ackerman & Truex, 2012). Reinikka and Svensson's (2004) research on the Ugandan government publicising education funding in local media allowed citizens and educators to monitor the funds their schools were supposed to receive and report any discrepancies (i.e. likely embezzlement). Their analysis shows that those areas with better access to local media and better educated school teachers experience lower levels of "leakage" of funds (Reinikka & Svensson, 2004, p. 14).

Other studies have shown that providing information to citizens could reduce corruption while at the same time raising the quality of government services. Peisakhin and Pinto (2010), for instance, found that when India passed the Right to Information Act in 2010, citizens were able to access public services in a timely manner and without paying a bribe, just by including the Right to Information Act request with their applications.

2.2.3.10 Privatisation

Previous research that examined the impact of privatisation on corruption reached different conclusions. While there have been some success stories of privatising public services or assets, there are also countries where privatisation has been a means of restructuring corruption schemes (or simply shifting corruption from public to private companies). Examples of success can be seen in the outsourcing of basic government services in some of India's rural areas (Bussell, 2012) and the privatisation of electricity distribution in Latin America (Wren-Lewis, 2015). On the other hand, the failure of privatisation programs against corruption, is documented in Uganda, with the privatisation of tax collection services (Iversen, Fjeldstad, Bahiigwa, Ellis, & James, 2006), and in Russia with the privatisation of some state enterprises (Black, Kraakman, & Tarassova, 2000).

The disagreement on the effectiveness of privatisation as an anti-corruption strategy could be rooted in the debate between rational choice theorists and collective action scholars on how to conceptualise or characterise corruption, as discussed in Chapter One.

Agency theory scholars, coming from a purely economic background, support privatisation as way of substituting “the potentially inefficient and corrupt distribution of resources through political institutions with the efficient ‘arm’s length’ allocation of resources through the market” (Hopkin, 2002, p. 583). Consequently, their anti-corruption prescriptions are centred on reducing the size of the state (which they distrust) and trusting the markets to eliminate, or at least reduce, the opportunities for corruption.

However, as illustrated in figure (1.1), agency theory takes the existence of both internal factors (active, clean, and powerful principal) and external factors (state capacity, clean judiciary system, and the political will to fight corruption) for granted. This could explain the failure of privatisation in many countries where one or more of these factors were missing.

As perceptively argued by Hough (2013, p. 6) and Hopkin (2002, p. 581), tackling corruption by simply reducing the size of the state is very deterministic, as Scandinavian countries are consistently rated within the top ten least corrupt countries

in the Corruption Perception Index, but at the same time have the largest public spending and public sectors. Hopkin (2002, p. 587) asserts that:

A society capable of acting collectively to establish a framework for the market economy... may well be capable of providing more substantial public goods without succumbing to corruption and inefficiency. Similarly, an interventionist state riddled with corruption may not be any more successful if its role is reduced to performing its core 'nightwatchman' functions... This suggests that other theoretical perspectives are necessary to explain the ways in which free-rider dilemmas [i.e. collective action problem] are, or are not, overcome.

Overall, there seems to be consensus that privatisation is a high reward, but high risk anti-corruption strategy and that the process of privatisation is very vulnerable to corruption. The usefulness of privatisation as an anti-corruption strategy is wholly dependent on the context. Privatisation is more likely to succeed in countries with greater levels of transparency in government, as well as greater accountability of public officials, and where there is a competitive economic system coupled with clean political leadership (Rose-Ackerman & Palifka, 2016; Rose-Ackerman & Truex, 2012; Tanzi & Schuknecht, 2000).

2.2.4 Context of the Study

In order to draw fruitful lessons from this research which will be relevant to other countries, one needs to understand the culture and the economic and political context in which this research operates. Consequently, this section briefly highlights the unique aspects of Saudi Arabia in terms of demography, economic power, government structure, corruption and anti-corruption efforts.

2.2.4.1 Demography

The total population of Saudi Arabia is around 27 million, of which expatriates represent 30% (CIA, 2014). However, only a very limited number of immigrants are allowed to work in the government sector. This can mainly be attributed to article 4 of the regulations on the appointment of non-Saudis, which prevents non-Saudis from working in the public sector with certain exemptions (Civil Servant Council, 1978). Such exemptions usually apply when state agencies demonstrate that no Saudi can be

found with the required qualifications and experience for the vacant position. Therefore, it is expected that the vast majority of interviews for this study will be held with Saudi nationals, who have similar culture, religion, language, and educational background.

2.2.4.2 Economic power

As the world's dominant oil producer and the largest country in the Middle East, Saudi Arabia is recognised as one of the twenty major economies in the world, often called G20. Saudi Arabia derives its economic power predominantly from holding one-fifth of the world's proven oil reserve (Shaahid, Al-Hadhrami, & Rahman, 2013).

In 1980 with the price of oil reaching its peak at over 35 US dollars, which equals \$103 per barrel in 2008 prices, the government sponsored thousands of Saudi students to study abroad, mainly in Western countries (Mouwad, 2008). The vast majority of these students returned to take up senior positions in the government. They have played a major role in reshaping Saudi society and enabling it to develop, like Western countries, in areas such as education, technology, law, economics, and accounting (AlOthilah, 2013, July 7). However, as in other countries, hundreds of books and articles have been published to red flag the consequences of westernization, sometimes called Americanisation or intellectual invasion, on culture and religion in Saudi Arabia. This can be seen by a simple Google search of the word “westernization” in Arabic (i.e. التغريب), which produces more than 850,000 books, articles, and websites discussing the negative effect of westernization on religious commitment, national identity, historical belonging, and cultural heritage. Recently, several protests have been held against “westernisation” even though protesting is strictly prohibited in Saudi Arabia (Reuters, 2014).

In the context of this research, the following two implications should be highlighted:

First, accounting and auditing practices in Saudi Arabia are strongly influenced and guided by American accounting standards, to the extent that the Saudi Organisation of Certified Public Accountants (SOCPA) has to justify any deviation from the American General Accepted Accounting Principles (GAAP). Such justification is normally shown in the appendix of all Saudi accounting or auditing standards. In a comparison between the US COSO internal control and the Saudi Auditing Standards, it is obvious that the

Saudi Auditing Standard number (11) copied the main components of COSO internal control framework, simply translating it into Arabic (Saudi Organization for Certified Public Accountants, 2000). This may raise scepticism about the effectiveness of COSO framework in Saudi Arabia given its source and presumed universal application. One contribution of this research is to determine whether a developing country, such as Saudi Arabia, is able to copy and implement internal control standards as practised by Western countries.

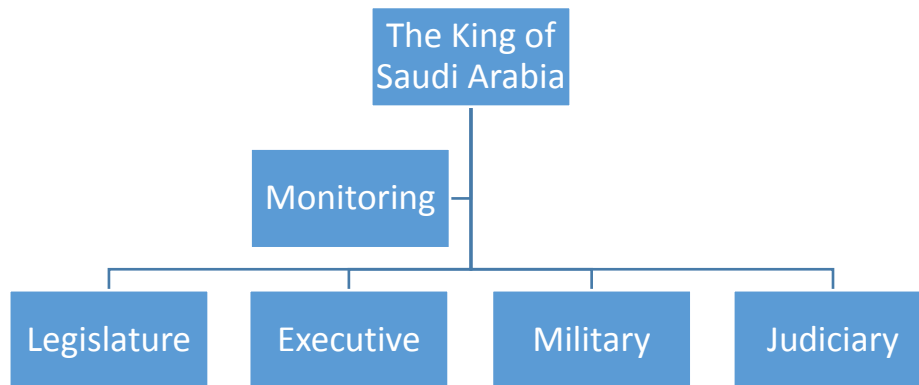
Second, when interpreting the outcomes of this research it is crucial to consider the economic aspect of Saudi Arabia. As argued by some authors, top down anti-corruption mechanisms are likely to succeed in rich and developed countries rather than poor countries (e.g. Ahmad & Giorgio Brosio, 2006). To be more specific, the main research hypothesis (i.e. internal control leads to a lower perceived level of corruption) might be correct, but only applicable to countries with similar economic characteristics to those of Saudi Arabia. For instance, in low GDP countries where the salaries of public officials are not enough to cover their basic needs, it is expected that they, as rational actors, will become corrupt regardless of quality of internal control in place. Consequently, a bottom up approach might be more effective in tackling corruption in these countries (Ahmad & Giorgio Brosio, 2006; Hertog, 2011)

2.2.4.3 Government structure

As Saudi Arabia is an absolute monarchy, its government is fully controlled by the King. As per article 44 and 60 of the The Basic Law of Governance (1992) (i.e. the constitution of Saudi Arabia), the King supervises and has ultimate power over all legislative, executive, military, judiciary, and monitoring bodies in Saudi Arabia. However, articles 7 and 8 of the same law articulate the expectation and responsibilities of the King, clearly stating that his conduct should be governed by Sharia and Islamic law, and all citizens should be treated with justice, fairness, and dignity. The following figure shows the government structure in Saudi Arabia.

Figure 2.1

Saudi Government Hierarchy



Source: own design

Legislature: Council of Ministers and the Shura Council (i.e. parliament) are the main legislative bodies in Saudi Arabia. They draft and propose laws for the King. However, these laws are not enforced until the he ratifies them. Typically, the process of enacting the law starts from the Shura Council; it is then discussed at the Council of Ministers. In case of disagreement, the King decides how to proceed. Yet, such disagreement rarely occurs because the King also holds the position of Prime Minister (Alsyat, 2014, July 6).

Executive: unlike most Western countries, the Executive does not only act as the administrative arm of the government. Under Council of Ministers law, ministers are empowered to propose legislations to the Council, which then has the legislative power to pass or oppose these legislations. Thus, the Council holds both legislative and executive powers. This combination has triggered many writers, like Alhsan (2010, February 11), to question whether it is appropriate for the country to continue with this overlap between the legislative and executive branches of the government in the future.

Military: military power is estimated to consist of around 250,000 individuals, which equals approximately one percent of the total population of Saudi Arabia. According to CIA (2014), the government has spent seven percent of its GDP annually on military expenditure since 2010. As a result, Saudi Arabia is ranked as the third highest country

in terms of military expenditure, just below South Sudan and Oman. This could be attributed to the current instability in the region and threats presented by Shia radicals backed by Iran and Al-Qaida linked militants on the northern and southern borders of Saudi Arabia (Gasim, 2014; Katz, 2014). Overall, in terms of security and political stability, Saudi Arabia is considered an oasis in a very unstable region (Gause III, 2011).

Judiciary: the Saudi judicial courts can be classified as follows: sharia courts, boards of grievance, and tribunals. Corruption cases are usually uncovered by monitoring bodies, such as an anticorruption agency; they are then prosecuted by the Investigation and Prosecution Authority before the Board of Grievance. As per Article 8 of the Board of grievances law (2007)²⁶, the board consists of three courts: administrative courts (i.e. the first instance court), appellate courts, and the Supreme Court. Each court case, as articulated by Article 9 of the Grievance Law, must be examined by three judges at each level of the Board of Grievance hierarchy. However, the law allows the board to authorise only one judge to decide cases in the first instance court.

Monitoring: various government organisations are obliged to control corruption in Saudi Arabia: the National Anti-corruption Commission (Nazaha²⁷), the General Audit Bureau (GAB), the Ministry of Finance (MF), the Ministry of Civil Service (MCS), and the Investigation and Control Board (ICB). While Nazaha bears the ultimate responsibility for tackling corruption and protecting integrity in both the public and private sectors, GAB, ICB, MF, and MCS play different roles in preventing, deterring, and detecting corrupt practices in state organisations. In particular, MF and GAB monitor compliance of state revenues and expenses regulations by auditing financial transactions in ministries before and after they occur respectively. MCS controls the employment and development of public servants to ensure that all recruitment and training is based on merit, fairness and equality irrespective of their status. ICB has recently been restructured to make it more focused on detecting administrative violations, such as violation of government authority matrix (Alzeban, 2010).

²⁶ This law is only one outcome of King Abdullah's US \$1.6 billion project to reform the judiciary system in Saudi Arabia. This reform has been recognized and appreciated by many countries, including the UK Foreign and Commonwealth Office.

²⁷ "Nazaha" means "integrity" and it is widely used to refer to the Anti-corruption Commission in Saudi Arabia.

It is essential to consider the government structure and political situation of a given country to enhance the generalisability of this research. For instance, as can be easily observed from international corruption perception indices, there is a strong correlation between corruption and political instability. In countries where violence is widespread, rule of law is weakened and corruption becomes systemic and embedded in the society. Thus, internal control might not be an effective tool in confronting corruption because rational actors know that there are limited consequences of indulging corrupt practices.

2.2.4.4 Corruption in Saudi Arabia

As with most developing countries in the world, corruption is a major challenge for policy makers in Saudi Arabia. In his recent book, the former president of the National Anti-Corruption Commission, summarises how and when corruption has increased and decreased in Saudi Arabia over the past five decades. He states:

Form my position as a corruption watcher who has been interested in corruption cases over the past 50 years, I can say that corruption increases with a flourishing economy in Saudi Arabia, in which the budget and the number of projects become inflated, and vice versa. Yet notable increases have been witnessed in the levels and types of corruption over the past twenty years, prior to the establishment of the commission [i.e. the Saudi anti-corruption commission which was established in 2011], in which Saudi Arabia had a continuous economic surplus. At that time [during the 20-year period of economic surplus], talking about corruption was not implicit, but it became explicitly addressed in some media, through articles, media programs, social media, and public conversations (Alsherif, 2016, p. 148).

He further explains the most widespread forms of corruption in Saudi Arabia by stating that:

It might be strange to see favouritism at the top of the list of corrupt practices witnessed in Saudi Arabia... [This] could be attributed to society's traditions of giving importance to people in key public positions, and those with social capital and wealth. Other reasons are related to weak laws, and its enforcement in an unfair manner, and the absence of monitoring and punishment. The most affected fields of favouritism are the appointment to government posts (in higher and lower positions), the assignment of public contracts, and the granting of licenses for professions, services, and business activities (Alsherif, 2016, p. 149).

Consistent with the literature, defining corruption in Saudi Arabia is problematic for several reasons. Firstly, to some extent corruption is a socially rooted and constructed phenomenon. What is considered corruption in one country could be considered as a

routine way of doing business, or a gift, in another (Dimant & Schulte, 2016; Hough, 2013; Kaufmann & Vicente, 2011). Secondly, corruption is a very sensitive topic as it is mostly associated with flagrant illegal activities, therefore there has been very limited research that traces the cultural and social origin, meanings and processes of corruption in Saudi society. However, legally speaking, the Saudi Anti-corruption Agency applies the World Bank's and Transparency International's definition of corruption (i.e. the abuse of entrusted power for private gain) in filtering out corruption from normal practices (Alsherif, 2016).

From an international perspective, since the establishment of the National Anti-Corruption Commission in 2011, Saudi Arabia has gradually improved its position in the international corruption indices, notably in Transparency International's (TI) Corruption Perceptions Index and The Worldwide Governance Indicators (WGI) Control of Corruption Index. The country's scores in the Corruption Perceptions Index were 44 in 2012, 46 in 2013, 49 in 2014, and 52 in 2015 (Transparency International, 2015).²⁸ A similar improvement was shown in the Control of Corruption Index with scores of - 0.37 in 2011, - 0.06 in 2012, - 0.01 in 2013, and 0.10 in its latest report in 2014 (The World Bank Group, 2015).²⁹

2.2.4.5 Anti-corruption efforts in Saudi Arabia

There is very little argument that the establishment of the National Anti-Corruption Commission represents the most distinct event in Saudi efforts against corruption. The Commission was established in 2011 to carry out the following duties³⁰:

- To follow up on the implementation of any Royal Decrees made to benefit the general public.
- To receive corruption allegations and verify their authenticity prior to anti-corruption prosecutions taking place.

²⁸ Transparency International's (TI) Corruption Perceptions Index rates countries on a scale of 0 (highly corrupt) to 100 (very clean).

²⁹ The Control of Corruption Index rates countries between -2.5 (highly corrupt) and 2.5 (least corrupt).

³⁰ Further background information on the duties of the Saudi Anti-corruption Commission can be found in Alsherif's (2016) book.

- To assess the level of compliance in the implementation of the National Strategy for Promoting Integrity and Combating Corruption.
- To promote integrity programmes in both the public and private sectors.
- To review Saudi laws and government procedures to close loopholes that can be exploited for corrupt purposes.
- To monitor the system of financial disclosures of certain public officials to prevent their illicit enrichment.
- To follow up on the implementation of international conventions related to anti-corruption.
- To conduct an annual assessment of the status of corruption in Saudi Arabia³¹.

The impact of the Commission has been disputed in recent years. There has been very strong financial and human resource support from the king himself, with more than 500 lucrative positions being offered to the most qualified lawyers, engineers, and accountants. Such support appears to have helped the commission to fulfil its obligations in raising public awareness of corruption, following on from the ratification and implementation of The United Nations Convention Against Corruption (UNCAC) (Alsherif, 2016). However, the Commission has been largely criticized for being more focused on petty corruption cases, such as the usage of government cars for personal reasons (Alhidari, 2012). As stated by Dr Mohammed Al Zolfah, a member of the Saudi parliament,

There was an expectation that ‘the National Anti-Corruption Commission’ will give examples from one organisation such as, the head of this organisation is not competent to stay in his position for such reasons (Alhidari, 2012).

In turn, the Commission answers these criticisms by stating the following:

There is no clear standard through which one can determine that this a small or a big [corruption] case...but everyone agrees that regardless of how small or big corruption is, corruption is still corruption, and it could start small and

³¹ This is the index used in this research.

then get bigger... the commission has no authority 'to investigate', or punish³² (Alhidari, 2012).

The former president of the Commission further outlines obstacles that limited its effectiveness:

1. Weak co-ordination and co-operation between the commission and other government organisations, e.g. failure to comply with the commission's enquiries on potential corrupt practices within the 30-day time limit, as stipulated by law³³.
2. The process of bringing a prosecution and processing it through the courts is very slow as there is no system for 'fast-tracking' corruption cases through the courts.
3. The failure of the courts to provide the commission with their judgements, allowing it to follow up judicial proceedings with the recovery of corruptly acquired assets.
4. The delay in the enforcement of court judgements in corruption cases.
5. The inability of the Commission (on legal grounds) to publish the names of those officials found guilty of corruption. (Alsherif, 2016, pp. 190-197)

Four years after the establishment of the National Anti-Corruption Commission (and with plunging oil prices in 2015 and 2016), there seems to be little satisfaction regarding the performance of the commission, especially in meeting the high expectations of both the general public and political leaders in Saudi Arabia. This was clear in a recent TV interview with the Deputy Crown Prince Mohammed bin Salman. When he was asked whether the level of corruption in Saudi Arabia was as low as he would like, he stated the following:

Does corruption still exist? No doubt corruption exists [in Saudi Arabia]. It exists in all societies and all governments and with different percentages. What

³² The commission receives allegations of corruption, and its role is to gather evidence to verify whether there are grounds for a full anti-corruption investigation and prosecution. If that is the case, then the investigation is taken on by the relevant prosecuting authority – The Bureau of Investigation and Public Prosecution. The commission also decides if 'whistle-blowers' are to receive a financial reward for making their allegations known.

³³ This is despite more than five royal decrees urging government organisations to reply within the 30-day limit.

is important to us today is to become one of the frontrunner countries in combating corruption and to have one of the lowest corruption percentages in the world (Deputy Crown Prince Mohammed bin Salman, 2016).

The interviewer, then, asked him, “what are you going to do to achieve this?”, to which he replied,

Privatisation is a very important part. For example, the arms manufacturers, if listed on [the Saudi Stock] Market, I do not have to monitor it, the general public will monitor. Aramco,³⁴ if listed on [the Saudi Stock] Market, the general public will monitor...and international organisations will monitor. When there is more information published in the financial statements, [this leads to] high monitoring. Most of things that we are targeting is to not trace corrupt officials per se; but to restructure many [government] procedures to limit the opportunities for corruption and make them harder (Deputy Crown Prince Mohammed bin Salman, 2016).

It should be noted that Saudi Arabia has a successful track record regarding the privatisation of some public services in the country. For instance, in 1998 Saudi Arabia privatised the telecommunications service. Now, the Saudi Telecommunications Company (STC) is one of the largest and most successful companies in the world. This allowed STC to offer flexibility in terms of significantly increasing its employees’ financial compensation, and offering gold checks (redundancy payments and early retirement settlements) for inefficient employees. All these measures were taken to protect the company’s market share and competitiveness, not only in the local market but also internationally. Also, as with any publicly traded company, the Saudi Telecommunications Company (STC) was under public scrutiny, particularly from investors and analysts (Alonazi, 2007).

2.2.5 Internal Control within the Context of Anticorruption Reforms

As discussed in section 2.1, there is a small body of research that has investigated the relationship between internal control and corruption. In fact, only since 2015 has more research on the impact of internal control on corruption started to materialise. This includes the recent debate between Neu et al. (2015) and Sikka and Lehman (2015) on the role of internal control in tackling procurement corruption.

³⁴ Aramco is a state-enterprise that is in control of Saudi Arabia’s crude oil reserve.

Neu et al. (2015) argue that internal control could be employed to enhance actors' ethical behaviour within government institutions. They support their argument by showing how designing high quality forms to gather comparable, accurate and complete information on procurement activities could facilitate internal and external scrutiny, and therefore increase the probability of preventing and detecting corrupt practices. This indeed would change actors' behaviours as "interaction become organised around these forms in ways that the resulting pattern practices and interactions come to characterise government procurement... If successful, these patterned practices and interactions will then facilitate the construction of disciplined and ethical procurement participants" (Neu et al., 2015, p. 54). However, Neu et al. (2015) condition the success of effective internal control with the existence of the right political environment where full transparency is protected and respected and political interventions are limited.

In response to Neu et al.'s (2015) paper, Sikka and Lehman (2015) downgrade the importance of internal control, claiming that recent global business corruption cases suggest that super powerful corporations with annual revenues exceeding the GDP of some developing countries could circumvent internal control as it involves only one side of corruption, i.e. the demand side. Thus, they propose anti-corruption measures to eradicate the supply of corruption, such as debarment of corrupt companies, and prosecution of corrupt corporate executives as a more effective method of tackling corruption.

Furthermore, Ge, Li, Liu, and McVay (2016) and Shu, Wang, Zhao, and Zheng (2014) examine the effectiveness of internal control in tackling corporate corruption using quantitative research methods. Their findings suggest that strong internal control reduces the opportunities for executive management and major shareholders to abuse their positions for private gains. However, their research is limited to state-owned and listed companies in China.

This thesis is different from previous research that examined the relationship between internal control and corruption in a number of ways. First, it is the first to evaluate the effectiveness of internal control using the updated version of the COSO Internal Control Framework (2013). This updated version clearly divides internal control into 17 principles with 77 points of focus to clarify these principles, facilitating the evaluation of internal control effectiveness. Secondly, this research's units of analysis are

government institutions, whereas most previous research has been centred on the private sector, mainly taking listed companies as their units of analysis. This could be attributed to the difficulties associated with gaining access to the public sector to investigate such a sensitive topic. Last, but not least, this research distinguishes itself by paying extra attention to its methodology and case selection, trustworthiness, and ethical issues surrounding the investigation of this topic, all of which were explained in Chapter One.

2.3 LITERATURE REVIEW OF INTERNAL CONTROL

2.3.1 Internal Control: Development and Usage

With regard to the internal control literature, previous studies have been limited to examining a small number of internal control mechanisms, such as internal audit, and evaluating their effectiveness (e.g. Alzeban, 2010), while others have examined how situational crime prevention can be used to prevent corruption (Graycar & Sidebottom, 2012). Originally, internal control was introduced in accounting and auditing to refer to internal accounting controls. The main purpose of internal accounting controls was to ensure the reliability and validity of financial statements (Mafiana, 2013). There is disagreement regarding when the expression "internal control" was first recognised in organisations. However, several pieces of research confirm that it was only in the 20th Century that internal control was first acknowledged as a subject and gained attention from both government and private sectors (Mafiana, 2013).

According to Brown (1962), prior to 1850 the importance of internal control in detecting fraud and errors was not recognised. Between 1850 and 1905, the UK witnessed great economic development and it was home to what became the Industrial Revolution. This resulted in family businesses being transformed into corporations and management being transferred from owners to professional managers. At the beginning of this era, owners started to make periodic reviews of their own corporations. However, this approach was not practical as these reviews required minimum skills and knowledge. Consequently, the demand for audit and internal control emerged as a tool to protect the owner's investments.

In 1892, Dicksee was one of the first authors to highlight the role of the auditor and to identify certain internal control measures, such as segregation of duties, as being of importance, although he did not explicitly determine the “internal control” concept (Heier, Dugan, & Sayers, 2005). In 1948, the Committee on Auditing Procedures of the American Institute of Accountants (AIA) defined internal control as follows:

Internal control comprises a plan of organisation and all of the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourages adherence to prescribed managerial policies. (Heier et al., 2005, p. 48).

Between the 1950s and 1970s, in response to a large number of illegal acts including embezzlement and fraud, the American Institute of Certified Public Accountants (AICPA) issued a number of standards and guidelines related to internal control that clarify the responsibility of the auditor and management to detect errors and irregularities in financial reports (Heier et al., 2005).

In 1985, the Committee of Sponsoring Organisations of the Treadway Commission (COSO) was established to sponsor the National Commission on Fraudulent Financial Reporting. The National Commission in turn was sponsored by the following associations: the American Institute of Certified Public Accountants (AICPA), the American Accounting Association (AAA), Financial Executives International (FEI), the Institute of Internal Auditors (IIA), and the Institute of Management Accountants (IMA) (COSO, 2013). The main objective of establishing COSO was to provide guidance regarding internal control and risk management to reduce fraudulent reporting and enable good organisational governance (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013)

In 1992, COSO issued its first “Internal Control-Integrated Framework” which defined internal control and provided a guideline for evaluating internal control systems. According to D'Aquila (2013), this framework is considered a major improvement in setting internal control standards and it has gained broad acceptance over the past twenty years, not only in the US but globally. The framework has been translated into seven languages. Some researchers suggest that one reason that it was so widely accepted is that internal control is known to be essential in all areas of an organisation, not just in accounting and finance (Pfister, 2009).

Although the COSO framework represents “a model that has been adopted as the generally accepted framework for internal control and is widely recognised as the definitive standard to assess the effectiveness of an internal control system” (Mafiana, 2013, p. 12), some research pinpoints certain issues related to limited guidance on how to design and implement the COSO Internal Control Framework (Heier et al., 2005). In addition, the first edition of the COSO framework was not fully tailored to the public sector. This led the International Organization of Supreme Audit Institutions (INTOSAI³⁵) to update its 1992 Internal Control Standards for Public Sector based on the COSO model. The updated version was issued in 2004 (The International Organization of Supreme Audit Institutions, 2004).

In response to a change in operating environment, in 2010 COSO announced a project to revise its original Internal Control-Integrated Framework. COSO formed an advisory council consisting of representatives from all related parties (i.e. business, non-profit organisation, academia, and government) to contribute to the development of the original framework. It also involved contributors from outside the US, including France, China, Canada, Japan, Britain, Germany and Thailand (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013)

Although the core concepts of internal control remain intact, the updated framework has been enhanced to reflect changes in the business environment, technological advancement, corporate governance, and expectations related to preventing and detecting fraud. For instance, the updated framework introduced the term “corruption” for the first time and highlighted the importance of assessing corruption risks within an entity. As defined by COSO, the word “entity” could include any form of organisation such as companies and government agencies. The revised framework identifies the main characteristics of each principle associated with five internal control components. This facilitates the work of any person who intends to understand and assess the effectiveness or quality of the internal control of entity, including government bodies. Besides the COSO framework, several professional organisations have attempted to develop their own internal control frameworks. Nevertheless, these frameworks have

³⁵ INTOSAI was founded in 1953 as an independent, non-political organisation. It represents a platform for 192 Full Members (usually government external auditors) and five Associated Members to share their experience in government audit.

not gained worldwide acceptance in the same way that the COSO framework has (D'Aquila, 2013). According to Mafiana (2013), the most prominent internal control frameworks in the world are: Internal Control Integrated Framework (COSO), System Auditability and Control Report (SAC), Control Objectives for Information and Related Technology (COBIT), Guidance on Control (COCO), Framework for Internal Control on Banking Organisations (FICBO), Internal Control: Guidance for Directors on the Combined Code (Turnbull Report). The following section provides a brief overview of each framework, followed by an outline of Internal Control Standards for Public Sector (INTOSAI) which is related to this study.

2.3.2 Overview of Internal Control Frameworks

Internal Control Integrated Framework (COSO): In May 2013, the Committee of Sponsoring Organisations of the Treadway Commission updated the COSO framework, therefore it is considered to be one of the most recent frameworks facilitating the understanding of how to design, implement and evaluate effective internal control systems (D'Aquila, 2013).

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013, p. 1) defines internal control as “a process, effected by an entity’s board of directors³⁶, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance”.

System Auditability and Control Report (SAC): This report was published in 1991, and revised in 1994, by the Institute of Internal Auditors Research Foundation. It aims to address the needs of internal auditors in order to provide guidance regarding internal control in the context of information systems. SAC defines internal control as a group of processes, activities and persons devoted to achieving certain objectives in an efficient and effective manner. However, the cornerstone of this report is how to achieve the organisational information system’s objectives in terms of security and

³⁶ As noted by COSO, the term “board of directors” means “the governing body” including but not limited to board of trustee and supervisory board.

accuracy of information as well as being in compliance with relevant policies, procedures and regulations (Curtis, Wu, & Craig Jr, 2000; Mafiana, 2013).

Control Objectives for Information and Related Technology (COBIT): This was introduced in 1995, based on SAC and the COSO frameworks, as an attempt to “bridge the gap that exists between business control models (i.e. COSO) and the more focused control models for IT (i.e. SAC)” (Curtis et al., 2000, p. 66). Yet, even with its updated version in 1998, COBIT is still considered to be an information technology (IT) framework, which employs IT Control to support organisational operations in monitoring risk management, compliance with applicable laws, and consequently achieving its strategic objectives (Bernroider & Ivanov, 2011; Mafiana, 2013).

Guidance on Control (CoCo): The Canadian Institute of Chartered Accountants (CICA) issued CoCo based on the COSO framework in 1995 (Stringer & Carey, 2002). In fact, CoCo (1995, p. 27) clearly states that its guidance “builds on the concepts in the COSO document” and “organisations that follow this guidance will have thereby considered the components of the COSO framework”. However, CoCo is perceived to have a broader internal control model than the original COSO framework, which was issued in 1992 (Pfister, 2009). Specifically, CoCo expands the definition and scope of internal control to include certain aspects of management, such as strategic planning and risk management (Canadian Institute of Chartered Accountants, 1995). Even though the CoCo model was based on the COSO framework with additional enhancements, it has not attracted global attention comparable to the original COSO framework (D'Aquila, 2013; Mafiana, 2013).

Framework for Internal Control on Banking Organisations (FICBO): In 1998 and in light of the COSO framework and other models, the Basel Committee on Banking Supervision issued FICBO to strengthen internal control and improve risk management in the banking sector (Basel Committee on Banking Supervision, 1998).

Internal Control: Guidance for Directors on the Combined Code (Turnbull Report): In 1999, the Institute of Chartered Accountants of England and Wales issued the Turnbull Report. The London Stock Exchange required directors of listed companies to ensure that internal control systems were effective and in compliance with the requirements of the Turnbull Report. On the other hand, managements were expected to report on

whether boards of directors had evaluated internal control and external auditors were to report on this statement (Institute of Chartered Accountants of England and Wales, 1999; Kendrick, 2000). In 2005, the Financial Reporting Council updated the Turnbull Report. The aims of the revised edition were to address emerging risks, internal control failures, and changes in business environments (Financial Reporting Council, 2005).

Internal Control Standards for the Public Sector: These standards were updated in 2004 by the International Organization of Supreme Audit Institutions (INTOSAI). The main objective of the revised edition was to incorporate and implement the 1992 COSO model in the public sector with the following modifications:

1. Highlighting the ethical aspects of operations to prevent and detect fraud and corrupt acts.
2. Additional guidance on Information Technology (IT) controls.

These modifications were made to address recent developments in the public sector since the original COSO model was issued in 1992 (The International Organization of Supreme Audit Institutions, 2004).

2.3.3 Internal Control in the Context of the Public Sector

According to Sarens et al. (2010), one of the first pieces of international research on internal control in government bodies was conducted by Sterck et al. in 2005. They compared internal control frameworks in various countries to identify the basis of these frameworks. They concluded that COSO internal control components are very common in several countries.

In 2010, Sarens et al. published a paper titled, “Risk Management and Internal Control in the Public Sector: An In-Depth Analysis of Belgian Social Security Public Institutions.” The researchers utilised COSO *Enterprise Risk Management* (ERM) and INTOSAI *Internal Control Standards for Public Sector* to assess risk management and internal control in the Belgian public sector. They used a questionnaire to measure the main components of risk management and internal control. Their conclusion indicates the following:

- a) Internal control is more developed than risk management in Belgium, yet neither internal control nor risk management are considered highly developed.
- b) There is a need to develop a more appropriate internal control framework for the public sector than INTOSAI *Internal Control Standards for Public Sector*.
- c) COSO *Enterprise Risk Management* (ERM) cannot be applied as it is in the public sector.
- d) There is a need to develop a more objective tool to measure risk management and internal control in the public sector.

The Belgian case indicates that internal control frameworks might not be fully implemented in the public sector as suggested by the literature. However, with the updated COSO Internal Control Framework, this study can determine which elements of internal control are functioning properly in government organisations.

2.3.4 Evaluating the Quality of Internal Control

The literature review revealed that researchers use different methods to measure the quality of internal control, including interviews, case studies and surveys (Morehead, 2007). The following paragraphs briefly describe the most important ones.

Morehead (2007) measures the effectiveness of internal control in accounting to prevent and detect fraud within US non-government organisations working in West Africa. The study utilises a web-based survey to measure internal control and corruption because it is more “practical, reliable, effective, and expedient” (Morehead, 2007, p.58). To measure corruption, the survey addresses direct questions to employees working in NGOs such as “Has your organization been a victim of fraud or corruption at your field location? Yes, within the past 0 to 12 months. Yes, within the past 13-24 months. Yes, within the past 25-36 months. No. Don’t know” (p. 141). The study found that in general NGOs’ internal control systems are weak. The author argues that fraud and corruption risks increase within NGOs operating in countries that have low scores in Transparency International’s Corruption Perceptions Index.

Gupta (2008) documents how firms are using the COSO 1992 internal control framework to evaluate internal control under section 404 (a) control effectiveness requirements. She designed a survey, consisting of 49 questions, which targeted professionals with an accounting and finance background. After analysing 374 surveys, she concludes that firms depend more on internal control auditing standards than on COSO's internal control.

Lightle, Castellano, and Cutting (2007) discuss whether the survey could be used to assess the internal control environment (i.e. the first component of the COSO framework). They believe that the survey can be used to evaluate internal control environment, yet researchers should be cautious when interpreting survey results.

In the context of Saudi Arabia, the researcher was not able to find any research on the effectiveness of internal control either in the public or the private sectors. However, Alzeban (2010) examines the relationship between the effectiveness of internal audit and five other factors including the size of internal audit and the management support for the internal audit. He designed two questionnaires using the Likert Scale; one for internal auditors and the other for senior managers in Saudi government entities. He also conducted interviews with external auditors as well as with some public officials. He found that management support is the most important factor affecting internal audit in the public sector.

2.3.5 Internal Control Limitations

As mentioned in section III, internal control provides only “reasonable assurance” (not absolute assurance) in accomplishing an organisation's goals. According to COSO (2013), the most common inherent limitations of internal control are that:

human judgment in decision making can be faulty, external events outside the organization's control may arise, and breakdowns can occur because of human failures such as making errors. Additionally, controls circumvented by two or more people colluding and because management can override the system of internal control (COSO 2013, p. 137).

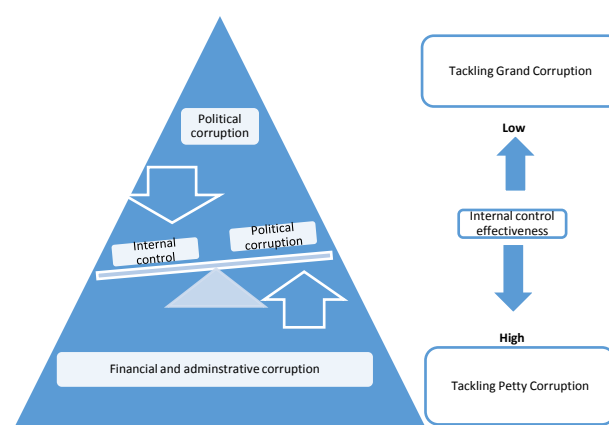
However, organisations can take measures to mitigate these risks such as building a culture of integrity, implementing a whistle-blower policy, empowering internal audit

functions, and attracting qualified board members (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013).

Indeed, as shown previously in section (1.2.1.1) in the Canadian case investigated by (Neu et al., 2013), corrupt politicians can restrict internal control in state agencies in order to prevent corrupt practices from being detected. The following figure summarises types of corruption and the extent to which internal control is effective in tackling them.

Figure 2.2

The effectiveness of internal control in tackling different types of corruption



Source: own design

2.4 CONCLUSION

As this chapter has demonstrated, most previous research has examined anticorruption reforms on a societal (sometime known as macro or national) level, only limited research has systematically examined the success or failure of anticorruption efforts at an organisational or institutional level in the public sector.

It is clear that there is no agreed-upon definition of corruption, as different disciplines use their own definitions. There are also major challenges in measuring the level of corruption, but it has been generally accepted in the corruption literature that perception and experience can be used as a proxy for measuring corruption.

What can also be seen from this is that the most important lesson to be learned is that anti-corruption measures which only concentrate on one element of corruption within an organisation are unlikely to be successful unless they are adopted as part of a number of measures. Essentially what is required is a bird's eye view of corruption in an organisation, looking down on the levels of corruption at all points within an organisation, and developing a holistic view when implementing a range of anti-corruption measures. This should prove more effective than introducing one anti-corruption measure, as introducing a measure such as staff rotation or a code of ethics alone is not a sufficient pre-requisite for reducing the overall level of corruption within an organisation. This thesis would argue that an effective implementation of COSO Internal Control Framework could provide this holistic approach to tackle institutional corruption.

The COSO Internal Control Framework appears to cover all aspects of government institutions, and divides them up into five areas. The first area is the control environment, which contains the following five principles: demonstrating a commitment to integrity and ethical values; the independence of the board of directors from senior management; the establishment of effective board oversight; a commitment to competency; and the accountability of individuals. In this study I have grouped these five principles into what I call soft control (rather than 'control environment' as per the COSO framework). This is because these principles are related to the culture of the organisation, and are therefore, to a certain extent, intangible features of an organisation.

The second area in the COSO framework is risk assessment, which is further divided into four principles: clarity of organisational objectives, the establishment of risk assessment approach, the analysis of fraud and corruption risks, and the identification of significant changes that might impact internal control.

The third area is control activities, which is divided into three principles: development of controls to mitigate risks identified in the risk assessment approach, establishment of controls over technology, and quality of policies and procedures.

The fourth area is information and communication, which is divided into three principles: using relevant information, internal communication and external communication.

For the purposes of this study, I have grouped risk assessment, control activities, and information and communication together as hard control. This is because these areas are related to policy documents and rules, which employees of an organisation are meant to adhere to. As such, they are more tangible than the features covered under soft control.

This divide between soft and hard controls was, to a certain extent, a personal judgement, as sometimes the line between what is a soft control and what is a hard control can be blurred. However, as I have used the COSO framework as a guide to this research, I have kept their groupings together as much as possible. In other words, the COSO framework has five main components to evaluate internal control, and for simplicity's sake I have grouped these components into three areas (soft, hard, and monitoring control).

The final area is monitoring activities, which COSO has divided into two principles: evaluation of internal controls and communication of their deficiencies.

The following two chapters build on the COSO framework in evaluating the effectiveness of internal control in two government funds. The main aim of such analysis is to see the extent to which internal control is effective in tackling corruption in government organisations. This was done by semi-structured interviews and document analysis to ascertain how the funds had designed and implemented each one of these principles. The analysis also shows how each principle of internal control contributed to higher or lower levels of corruption.

Chapter 3

The First Case Study: Fund A

3.1 INTRODUCTION

“Internal control” as a concept has always been used, not only in corruption literature, but also in anti-corruption legislation, including the US Foreign Corrupt Practices Act (FCPA) of 1977 and the UK Bribery Act (2010). However, the employment of internal control to tackle corruption was only expanded, on an international basis, from the private sector to the public sector with the introduction of the United Nations Convention against Corruption (article 9/2/d) in 2003.

Most governments in the world have simply copied the COSO Internal Control Framework to implement in the public sector. The International Organisation of Supreme Audit Institutions (INTOSAI), which represents government external auditors from 192 countries, adopted the guidelines for internal control standards in the public sector in 2004. These guidelines explicitly referred to the COSO framework and adopted its main elements (The International Organization of Supreme Audit Institutions, 2004).

Countries like the UK issued guidance to the UK Bribery Act 2010 that is very similar to the COSO framework (Ministry of Justice, 2011). Also, international organisations, like Transparency International, introduced anti-corruption programmes that were built on, or sometimes just copied, the main components of the COSO framework (Transparency International UK, 2010).

However, the COSO Internal Control Framework is largely theoretical, with little in the way of empirical research to assess its effectiveness, and in particular, which parts of it are the most effective. Therefore, this research is designed to assess its effectiveness, and to pinpoint which elements of it are the most effective in reducing levels of corruption (or keeping them at low levels) in order that governments may invest more resources in those elements and be more cost effective in achieving their objectives.

One of the main distinctions of this thesis is the application of COSO framework in a very detailed and rigorous manner. This ultimately enhances the usefulness, practical implication, and the generalisability of the findings of this research in the real world. The COSO framework set the stage when it came to determining which internal controls were effective and which were ineffective, and which were control environments (soft control) and which were not (hard control and monitoring control).

As summarised in figure (3.1), this chapter takes a more holistic approach to examining the effectiveness of Fund A's internal control in tackling corruption from the COSO internal control perspective. The first and most important strategy dealt with corruption arising from the agent *abusing his power for self-interest*. This research labels this strategy the **soft control anti-corruption strategy**, whereas the COSO internal framework labels it the control environment. Under this strategy, as is discussed throughout this chapter, Fund A's board of directors (the principals) introduced many initiatives starting with the establishment of the fund. The first initiative – and the cornerstone of the soft control strategy – was the appointment of director generals (the agents) with strong integrity credentials. For example, when the board appointed a Western financial institution to establish the fund, that institution appointed a professional with a reputation for high ethical standards to run it and establish its hard internal control, e.g. its policies and procedures that govern all of the fund's activities, to avoid any conflict of duties. Since then the board has consistently selected and empowered such director generals to manage the behaviour of sub-agents (all officials working under the supervision of the director general)³⁷. This is consistent with previous research which found the selection of clean agents to be a key control in fighting corruption within an organisation (Klitgaard, 2006).

The second initiative under the soft control strategy was to establish a very intensive training programme that all officials had to complete. This training programme was run by the same Western institution that established the fund, and all officials were expected to spend approximately one year working on secondment with the institution prior to officially taking up their position at the fund. Any official who failed the training programme was not permitted to take up their permanent appointment.³⁸

³⁷ Personal communication with interviewee 20

³⁸ Personal communication with interviewee 16

The second strategy was the **hard control anti-corruption strategy**, which consisted of the COSO framework's risk assessment, control activities, and information and communication components. This strategy dealt with *eliminating or reducing the opportunity of corruption* through hard control tools such as policy change, separation of powers, e-government, and transparency. The implementation of this strategy naturally followed on from the first strategy of appointing agents with strong integrity credentials as this was a pre-requisite for changing the policies that allowed corruption to occur. In the case of Fund A the agent (the director general) introduced the appropriate policies, which were approved by the principal, to remove opportunities for corruption within the fund. For example, Fund A did not require consultants to prepare feasibility studies for projects for which loan applicants applied for funding. In fact, applicants were actively encouraged to apply for funding themselves by providing templates and clear instructions for the entire loan application process on its official website, including feasibility studies. This policy helped the Fund to eliminate the need for middle men to facilitate the loan application process, whose very existence was an unnecessary bureaucratic hurdle, and could encourage the offering of bribes to speed up the process. By removing this unnecessary barrier, Fund A both sped up the application process and removed a potential cause of corruption.³⁹

The third strategy was the **monitoring control anti-corruption strategy**, which covered the observing of control activities as per the COSO Internal Control Framework. It involved Fund A's principal *reducing the levels of information asymmetry* that existed in the principal-agent relationship. This asymmetry existed where the board had limited access to information, and the flow of that information to them was controlled by the director general. Within Fund A, the board had, to some extent, mitigated this by limiting the appointment of their external financial auditors to one of the "Big Four" accountancy firms who reported directly to them. Fund A's board were aided in this by the fact that the external government auditors, in accordance with government policy across all government departments, reported directly to the board rather than to the director general.⁴⁰

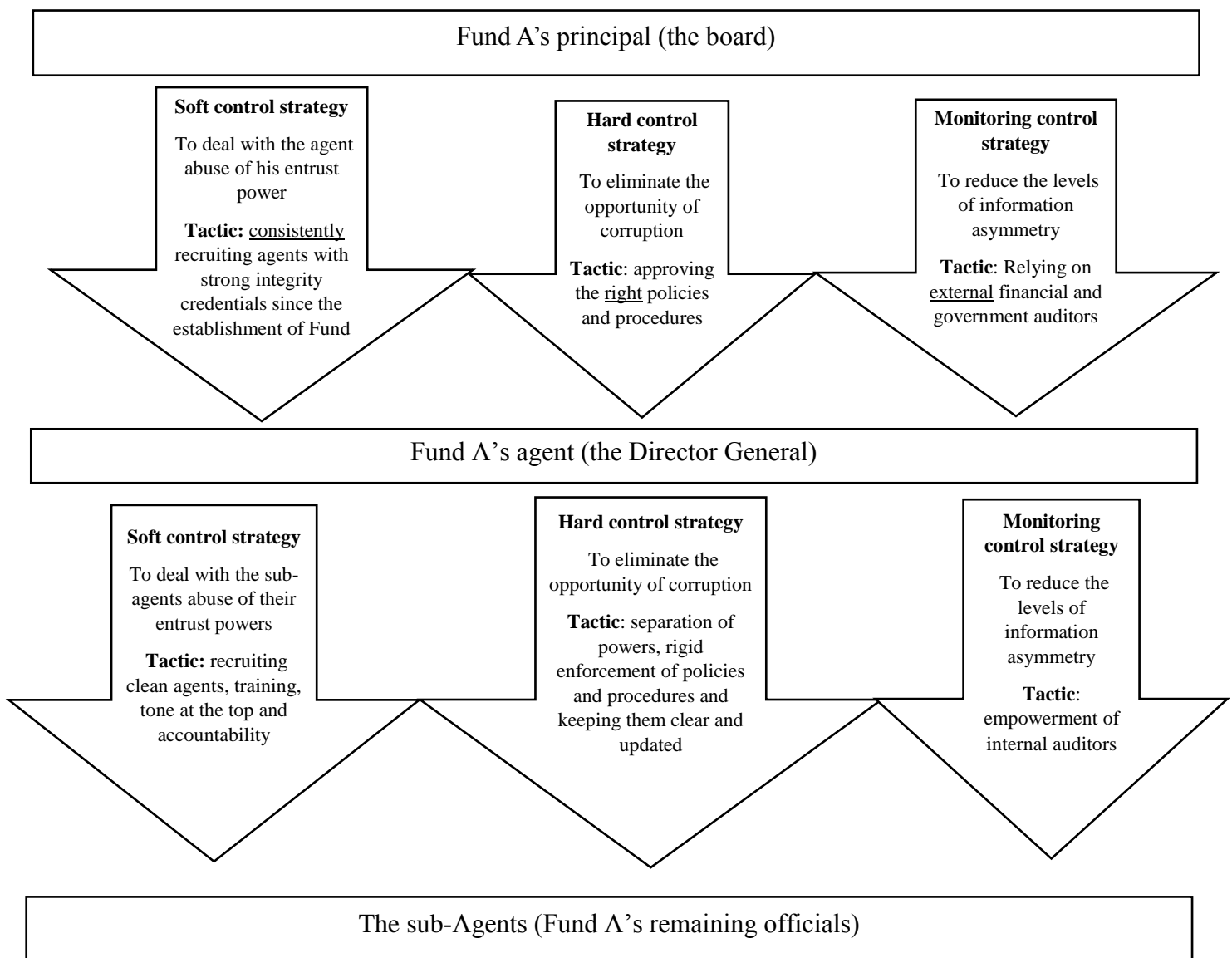
³⁹ Personal communication interview 22

⁴⁰ Personal communication with interviewee 4

Although all three strategies were successfully used by the principal and the agent to minimise the level of corruption within the Fund, in depth analysis revealed that the principal seemed to be more reliant on soft control strategies, such as recruiting clean agents, to prevent the director general from abusing his position, and the director general appeared to be more reliant on monitoring control strategies, such as reports from the internal auditors, to reduce information asymmetry that might lead to corruption.

Figure 3.1

Summary of Fund A Internal Control Strategies against Corruption



Source: own design

The rest of this chapter presents an in-depth analysis of the effectiveness of these strategies within Fund A, and argues that on the whole these strategies were effective in minimising corruption but to differing degrees. This chapter assesses the evidence supporting the hypothesis that an effective internal control strategy leads to a lower level of corruption, as well as any that does not support it, and then sums it up in the conclusion.

3.2 BACKGROUND INFORMATION

As per the Saudi Corruption Index (2014), Fund A was considered the least corrupt government agency in Saudi Arabia. This made it an ideal subject for research in this area as the analysis could focus on the lessons to be learned from how this fund had been able to minimise corruption using the strategies that have been discussed.

To protect the anonymity of the organisation and its officials, limited background information on the interviewees is provided here.

3.3 SOFT CONTROL ANTI-CORRUPTION STRATEGY

Soft control refers to the control environment in the COSO framework. It includes five principles:

1. Commitment to integrity
2. Exercising oversight responsibilities
3. Establishing structure, authority, and responsibility
4. Commitment to competence
5. Accountability

One of the major strengths of the COSO Internal Control Framework (2013) is the introduction of characteristics for each of these principles to facilitate the evaluation of internal control effectiveness. For instance, commitment to integrity includes setting the tone at the top, establishing standards of conduct and evaluating adherence to this conduct. Therefore, the following discussion will be centred on the quality and

enforcement of these characteristics in order to understand to what extent they contributed to Fund A's low level of corruption.

3.3.1 Setting the Tone at the Top

From the perspective of Saudi officials working in Fund A, the consensus was that the director general had set an example of high ethical values within the fund⁴¹. The majority of respondents stressed that through the full adherence of all policies and procedures from executive management down to front desk employees, a culture of integrity was promoted. One of Fund A's former officials illustrated how the director general had refused to accept an appeal by two of his close relatives who had not been accepted for two vacant positions, even though they met all the requirements and specifications of the posts. However, they were not selected because the interview committee thought other candidates were of better character. According to one ex-official at Fund A

Such a decision was judgmental and it would have been easy for him [the director general] to intervene and appoint his relatives. Yet he did not do so because he wanted to send a message that nepotism had no place in Fund A's business... he acted in this way to inspire all Fund A's employees to act professionally should they face similar pressure from relatives or friends.⁴²

Another senior official also stated:

Fund A gained its good reputation because of the controls that were put in place, starting from the director general at the tip of the pyramid, who if considered clean and free from corruption will prevent other senior managers from being corrupt. This is because if the other senior managers are corrupt, whistle blowers from staff closer to the base of the pyramid will know that they can report corruption to the director general... if the tip of the pyramid is corrupt, an employee knows how to get away with it.⁴³

⁴¹ E.g. personal communication with interviewee 20 and 23

⁴² Personal communication with interviewee 20

⁴³ Personal communication with interviewee 23

If the director general had allowed the appeal and appointed his relatives, overruling the interview committee's recommendation, this would have allowed senior managers to rationalise the appointment of their friends and relatives to other posts within the fund. This could then have spread throughout the entire recruitment process from the most junior posts to the most senior, allowing nepotism to override talent in the recruitment process. This would also have encouraged corruption in other areas of the business, as those officials who had achieved their appointment through corruption could assume that corruption was therefore acceptable throughout the fund.

There were many signs within Fund A that senior management were committed to integrity:

All staff, including the senior management and the director general, had to use fingerprint identification to confirm their attendance at work. They were not allowed to sign in voluntarily, thus reducing the opportunity to falsify attendance and time keeping records.⁴⁴

All staff were also reminded to save paper when printing and to conserve electricity when leaving the building at the end of the day by turning off lights and computers. This was done in two ways: e-mails from senior management⁴⁵ and signs displayed in every printing and photocopying room as observed by the researcher. This was designed to create a culture whereby wasting government resources was considered to be unacceptable, and thus it logically followed that the misappropriation of government resources (i.e. fraud or embezzlement) would also not be tolerated by senior officials.

However, many of the employees from Western countries had a slightly different perspective, in that the standards of ethical practice were not quite as high as in their own countries. For example, travel tickets were given for business class travel, but many employees took the money for business class, and then booked an economy class ticket (or sometimes did not book a ticket at all) and then pocketed the difference.⁴⁶

Also, many employees claimed for overtime that they had not worked – claiming an extra hour over and above those that they had actually worked. Western employees

⁴⁴ Personal communication with interviewee 22

⁴⁵ Personal communication with interviewee 22

⁴⁶ Personal communication with interviewee 32

also tended to think that Fund A was over-staffed and that a number of colleagues were under-worked,⁴⁷ although, this was mixing up ethical behaviour with efficient staffing levels.⁴⁸

There seemed to be a direct link between the tone at the top of the organisation and the rationalisation of corruption. Fund A was set up with the help of a Western bank from a country which Transparency International rates as one of the least corruptible, and their standards of ethical conduct appeared to have been transferred to the majority of officials working at Fund A. This could be seen in their low levels of corrupt practices, as shown through the Saudi Corruption Index (2014) and interviews conducted in this research.

The signals received from the top affected the culture of the organisation throughout. If the policies regarding attendance and prompt arrival at work were adhered to by senior managers, then they were more likely to be adhered to by staff. If staff were given the message that all policies were complied with by senior management, they would form the opinion that all policies were equally applicable to themselves.

The decision to remind staff not to waste government resources by using them efficiently and not wasting paper or electricity sent a strong message throughout the organisation that government money was to be used properly and for the purpose for which it was intended. If the waste of resources was tolerated by management, the next step would be to use government resources for personal use, then for personal enrichment, which would be embezzlement – a clear form of corruption.

Although the tone at the top seemed to have been set correctly at Fund A, this did not mean it was 100 per cent clean from a Western perspective. The practice of claiming money for business class travel but booking economy class and pocketing the difference may be seen as corruption in the West (and might actually be illegal), but this could be down to a cultural difference. For a start, this practice is not illegal in Saudi Arabia, nor is it outlawed by the bylaws governing Fund A. In addition to this, the practice is widespread throughout Saudi government organisations and by senior and junior officials alike, and is not viewed as corruption within Saudi Arabia. This may help to

⁴⁷ Personal communication with interviewee 31

⁴⁸ The pocketing of the cash difference between business and economy fares would be considered outright fraud in many Western countries, leading to a charge of gross misconduct at the very least.

explain why a practice that appeared to be corrupt (in the view of westerners) did not spread corrupt practices into other areas of Fund A.

3.3.2 Establishing Standards of Conduct

Fund A's commitment to integrity was not only demonstrated through the expectations of the board and senior management, but it was also enshrined in the organisation's standards of conduct, particularly through the HR manual and credit policy guide. The HR manual stated that "conflict of interest must be avoided" and "confidentiality must be protected at all times". The credit policy guide, the most important manual governing Fund A's loan application process, had a separate section on ethics which addressed employees' professional conduct. Other sections covered confidentiality of information, conflict of interest, policy regarding gifts, and ownership of files and documents.

The main aim of enacting ethics in the credit policy guide was to set out the expectation of Fund A's Credit Department employees' behaviours. The guide stated:

All officers of the Credit Department are professionals and are expected to conduct themselves in accordance with professional standards which are accepted internationally.

The Fund demands and expects that all professional employees will observe the professional rules of conduct and dress code which apply to their respective disciplines.

So, the Fund expected its officials to adhere to international standards, not just to the code of ethics of the Saudi civil service or other local government agencies. However, there was no reference to any code of ethics that was recognised as being accepted internationally for officials to follow. Furthermore, it was unclear if professional rules of conduct differed between disciplines, and Fund A did not have professional rules for any specific discipline. Also, the manuals were written in English⁴⁹ for implementation by the Western bank that was instrumental in the establishment of the fund. Since the

⁴⁹ It should be highlighted that the credit policy guide was only written in English and has never been translated into Arabic, other than the letter templates which are in Arabic. However, the vast majority of Fund A's employees speak English.

establishment of the fund, code of ethics articles in the guide had not been the subject of an audit, review, or update.⁵⁰

Whilst having an established code of ethical conduct ingrained in the organisation from its outset could be said to have acted as a limit on corrupt practices within Fund A, with senior management having acted in the best interest of the Fund and seemingly never having intervened in its day-to-day operation for personal, private gain, this alone did not explain the low levels of corruption. Only a limited number of executive managers were aware that a written code of conduct even existed. The vast majority of interviewees, including most of the internal auditors and HR employees,⁵¹ thought that Fund A did not even have a written code of ethics. Therefore, it could be concluded that there was a weak relationship between merely establishing a code of conduct without a serious attempt at enforcement and Fund A's low level of corruption.

3.3.3 Establishing Oversight Responsibilities⁵²

The nature of the loans made by Fund A were necessarily complex. Such complexity created opportunities for corruption because the loans were largely for multi-million dollar sums and were very different in scope from each other⁵³. However, in spite of this, the level of corruption has remained low. One factor that may have contributed to this low level of corruption was the consistent employment of one of the 'Big Four' accounting firms as external auditors since the Fund's establishment. Due to their rigorous procedures for external audit, the Big Four would have refused to tender for business that might have compromised their own integrity and reputation⁵⁴.

The board of directors always insisted on appointing one of the internationally recognised 'Big Four' accounting firms to carry out Fund A's external audit. Their audits included an assessment of an organisation's internal controls. The 'Big Four' also adhered to internationally accepted standards of reviewing and assessing the

⁵⁰ Personal communication with interviewee 22

⁵¹ Usually internal auditors or HR officials are responsible for evaluating adherence to standards of conduct.

⁵² This section is based on personal communication with interviewee 4

⁵³ Personal communication with interviewees 2 and 25

⁵⁴ Personal communication with interviewee 4

fairness of Fund A's financial statements. Therefore, all their reports stated the following:

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, *the auditor considers internal control relevant to the entity's preparation of financial statements* that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control⁵⁵. [Italics are from the researcher]

This appointment of one of a select few internationally recognised auditing firms was designed to show that the auditing process was corruption-free, because these firms have no family/tribal links to anyone within Fund A. Consequently, the likelihood of allegations of nepotism or corruption playing a part in the appointment process was far lower than if a local firm had been appointed⁵⁶. These external audits provided some assurance to the board of directors that the Fund's policies and procedures were implemented properly. This was because the "Big Four" carried out pre-audit questionnaires prior to even tendering for a contract to become external auditors. As one of Fund A's previous external auditors stated:

Before accepting any client, Big 4 accounting firms use almost 200 standardised preliminary risk assessment questionnaires to assess factors such as *tone at the top*, potential exposure, last audit adjustments, reasons for changing external auditor, and *control management override*. The result of such assessments are usually low risk, medium risk, or high risks clients. In very rare circumstances, we accept high risk clients, in which case we have to take extra precautions measures to closely monitor the audit of these clients...

Fund A is a very low risk client because authority is delegated properly. There is no conflict of interest as the director general has limited authority and there is segregation of duties between custody, recording, and approving transactions within Fund A⁵⁷.

Also, the Big Four has such a huge portfolio of clients that one client, no matter how large, cannot be seen to have an influence on how an external audit is carried out and so corrupt practices were unlikely to be hidden from the external audit team. This was

⁵⁵ Personal communication with interviewee 22

⁵⁶ Although it should not be assumed that the big four are incorruptible, as Arthur Andersen's relationship with US energy firm Enron demonstrates.

⁵⁷ Personal communication with interviewee 22

designed to provide a signal that Fund A's accounting procedures were clean and untainted by corruption.

Furthermore, the board of directors consistently appointed general directors who were regarded to have high ethical reputations. This helped the board's oversight function, as a clean director general could be trusted to supervise and monitor all of the Fund's officials to make sure they were in compliance with the board's approved policies and procedures and their directions. This was evident from the director generals' empowerment of internal auditors to scrutinise every aspect of Fund A's business and encouraged rigorous analysis to prevent corruption. It could be a worrying sign that the Internal Audit Department's reports had to go through the director general because this could have hindered the board's ability to monitor management's performance. However, this did not seem to be the case in Fund A, simply because the senior management had demonstrated a commitment to integrity since the establishment of the fund, as well as providing absolute support to the Internal Audit Department.

The number of loans authorized by Fund A annually did not normally exceed 150, and since the establishment of the fund, the total number of loans approved was approximately 4,000⁵⁸. This low number allowed the board of directors to implement rigid internal controls. The director general always reported all loans made by the fund to the board, regardless of the size. Therefore, the board was aware of every loan made, including those which fell within the authority of the executive management. In addition to this, the board had to authorise all loans in excess of USD 8 million.⁵⁹

The director general's decision to keep the board informed of all loans made by the fund acted as an internal control on corruption, even though the director general had the final say on loans under a certain limit (USD 8 million). The board was also responsible for all decisions made on loans above this limit, which acted as a further preventative measure against large scale loans being issued corruptly.

The director of the Internal Audit Department was appointed, with the approval of the board, until retirement age, and was permitted to act independently from the director general. This can be seen from the fact that all reports from the Internal Audit

⁵⁸ Fund A annual report 2014

⁵⁹ Personal communication with interviewee 27

Department were passed unedited to the board of directors without any modification from the director general. As well as appointing the director of internal audit, the board was the only body empowered to accept his resignation, and if this happened only the board could approve his replacement. Therefore, in theory he was free to act without undue influence from the management or fear of losing his position. However, his bonus and vacation requests were subject to approval from the director general, which could be seen to have acted as an influence on his actions.⁶⁰

As the director of internal audit could act freely without fear of having his contract terminated, he was empowered to detect corruption without interference from the director general. This was potentially a strong internal control on corruption within Fund A. However, the fact that the director general was the gate-keeper when information was passed from management to the board was a potential weakness, because if the director general saw all reports that criticized the management, he could have edited the reports should he have chosen to as there was no official policy to prevent him from doing so. The director general believed that the Audit Department existed to help him ensure that all departments were in compliance with Fund A's manuals and directions – in his view the director of internal audit worked for him, not solely for the board of directors⁶¹. It would seem that the Internal Audit Department reciprocated by providing the director general with detailed reports, with a more general, more concise version provided to the board. In addition to this, the fact that the director of internal audit would have known that the director general read their reports may have meant that reports on breaches of the fund's credit policy guide were never submitted if there was a concern that the director general might suppress them. For example, the Internal Audit Department reviewed loan disbursements as part of their work, to assess their compliance with the fund's credit policy guide, as breach of this guide was a possible indicator of corrupt practice. However, there were grey areas in the policy guide and the director general made the decision to approve loans that fell into these grey areas. The fact that the director general took these decisions was a potential weakness in this line of reporting. If the internal auditor thought that these loans should have been referred to the board for their approval, any report stating that

⁶⁰ Personal communication with interviewee 12

⁶¹ Personal communication with interviewee 25

the director general had breached the credit policy guide would have been read by the him prior to submission to the board⁶².

3.3.4 Applying Relevant Expertise

The COSO framework states that the board of directors should define, maintain, and periodically evaluate the skills and expertise needed among its members to scrutinise senior management. There did not appear to be any formal method of doing this within Fund A; it was reliant on this exercise being undertaken prior to their appointment by the government.

The chairman of the board was a vice-minister, and the other board members were also high-ranking officials from government ministries and agencies, all with many years of experience in senior government posts and relevant expertise. For example, one of the board members was a qualified engineer with relevant supervisory experience. None of the board members were from the private sector.⁶³

Since all Fund A's board members were highly ranked officials within other government organisations, they were more likely to have the required skills and experience to oversee the executive management and assess their performance. This in turn might have contributed to maintaining low corrupt practices within Fund A.

3.3.5 Board Independence

As mentioned previously, Fund A's board of directors consisted of five highly experienced and qualified government officials, who were independent of the director general who, unlike in many other government agencies, was specifically excluded from being on the board. This degree of independence from management is shown as per article 9 of Fund A's bylaw:

There shall be a director general and deputy of the fund. The general director is responsible to the board of directors for implementing and supporting the fund's

⁶² Personal communication with interviewee 13

⁶³ Personal communication with interviewee 18

policies, guideline, and decisions taken by the board of directors. The director general shall attend the meetings of the board of directors, participate in discussions, and sign the minutes; yet he has no vote in the discussion.

Hence, this article articulates the line between the board of directors and the executive management. The director general had no voting power on the board, which also held the director general accountable for implementing all Fund A's policies and procedures manuals. This greatly reduced the potential for any conflict of interest between the board members' responsibilities for the fund and any personal gain, as the board members were not involved directly in the industries to which the fund made its loans.

As the senior management of the fund reported to the director general, who was responsible for their day-to-day management, the board was able to oversee senior management without being directly responsible for their day-to-day management. This enabled them to be more objective when analysing the performance of senior management and assessing any potentially corrupt practices.

3.3.6 Providing Oversight of Internal Control

The board provided oversight for the system of internal control by seeing the unedited reports of the head of internal audit – the director general did not edit or 'water down' any of the assessments of the Internal Audit Department⁶⁴. This meant that the board was, to some extent, aware of how anti-corruption policies were being enforced, which acted as a strong control on the potential for corruption.

In addition to this, the external government auditors usually reported directly to the chairman of the board, not the director general. As such, both of these measures allowed the board to provide a degree of oversight of the systems of internal control.⁶⁵

However, as mentioned previously, the Internal Audit Department had no direct link to the board. As stated by one interviewee from the Internal Audit Department:

There was no direct contact between the Internal Audit Department and the board of directors. ... [internal auditors] had access to the minutes of their

⁶⁴ Personal communication with interviewee 12

⁶⁵ Personal communication with interviewees 1 and 7

meetings so were aware of what had been discussed but had no one-to-one meetings with the board⁶⁶.

The fact that Fund A's board had a degree of oversight of the system of internal controls, including access to the Internal Audit Department's reports, and the external government auditors reporting direct to them, empowered the board to carry out their function of oversight of the systems of internal control effectively. This could be seen as a deterrent, preventing senior management from allowing corrupt practices within their departments and an incentive to stamp out any corrupt practices they may uncover.

3.3.7 Establishing Structure, Authority, and Responsibility

This section discusses hierarchical management structure, reporting lines, and limiting authorities and responsibilities within Fund A.

3.3.7.1 Hierarchical management structure

Fund A's structure was very clear and determined the responsibilities of all departments. It was established for the long term and was designed to provide checks and balances on the control and management of the organisation so that no one, including the director general, had the power to make all decisions.

Every department had a manager and an assistant manager and consisted of two teams. There appeared to be a lot of duplication of duties by managers and their assistants, and by the two teams within each department. There was scope for a more efficient management structure within Fund A.^{67 68}

All loan applications had to be sent to the Customer Service Department in the first stage – this step could not be bypassed, thereby reducing opportunities for corruption. All loans were subject to a deep analysis from the Credit Department, with input from the Technical and Marketing Departments; this input was documented and attached to

⁶⁶ Personal communication with interviewee 14

⁶⁷ It should be noted that this could be considered poor resource management i.e. lack of competence, which is obviously different from corruption.

⁶⁸ Personal communication with interviewee 17

the Credit Department's report. Interviews with credit analysts revealed that they were never under any pressure or influence from anyone to approve an application. They were empowered to make their decisions on an objective basis without interference. At this level, even if the credit analysts were tempted to be corrupt it was not possible as the final decision was not theirs to make. If the application passed this stage, it was forwarded to the loan committee for approval, the members of which had sight of the entire application file, not just the recommendations. Even at this stage, if the application was for more than USD 8 million, it was subject to approval from the board.⁶⁹

The director general and his deputy sat on the loan committee which received all the information from the Credit Department and discussed the merits of all loan applications. The loan committee then made the decision regarding whether to approve a loan. If the loan was above USD 8 million, the application had to be submitted to the board of directors for approval; however, if it was below USD 8 million, it was submitted to the management committee for final approval. The director general sat on this committee with his deputy and no one else. They then had another opportunity to approve all loans below USD 8 million⁷⁰. However, it was difficult to see why this extra step was needed as both the director general and his deputy had already had the chance to discuss the merits of the loan and accept or reject it at the loan committee stage. One senior official claimed that this extra stage was unnecessarily bureaucratic with no obvious function.⁷¹

Without clear organisational structures with checks and balances on the loan application procedures, too much decision-making power could be concentrated in one or a few individuals. The structures within Fund A would have helped prevent systemic corruption within the fund that may not have existed in other government agencies. The duties were segregated to individual departments and there was a clear procedure for approving a loan application to be passed to the next stage of the process.

With regard to having the director general and his deputy sitting on the loan committee and the management committee, this may have given the director general and his deputy

⁶⁹ This paragraph is based on personal communication with interviewee 21

⁷⁰ Personal communication with interviewee 26

⁷¹ Personal communication with interviewee 25

too much power. They sat in on the discussions regarding the merits of the loan and had a say in whether or not it was approved, and then had a further say at the management committee stage. It could be suggested that they should not sit on both committees, but only on the management committee to make decisions that have been fully discussed and approved by the loan committee. Or if they insisted that they must be allowed the opportunity to discuss the merits of a loan application with the various departments who recommend (or not) the applications, that this second committee stage was unnecessary and the application process could be made more efficient by cutting this stage out altogether as the director general and his deputy had already given the applications full scrutiny at the loan committee stage.⁷²

The counter-argument in favour of having the director general and his deputy sitting on both committees, and assuming that they were incorruptible, is that they were in a better position to scrutinise all the loan applications by asking direct questions of the heads of all departments involved in the loan application process. For example, they could ask the Technical or Credit Departments to rationalise their recommendations.⁷³

3.3.7.2 Establishing reporting lines

In line with Institute of Internal Auditors (IIA) standards, Fund A claimed to have three lines of defence against corruption:

1. The operational managers who ran their departments on a day-to-day basis, and as part of their duties had to prevent corrupt practices within their departments.
2. The Risk Management Department, whose duties included assessing different types of risk, including corruption risks, and suggested measures to mitigate these types of risk, and then oversaw the implementation of these measures once approved.

⁷² Personal communication with interviewee 26

⁷³ Personal communication with interviewee 26

3. The Internal Audit Department, whose duties included assessing the compliance of all departments with policies, procedures, and directions approved by the board, and reporting any breaches to the board through the director general.

In Fund A, every loan application was examined by a credited analyst and then reviewed by his superiors, including the team leader, and the head of the Credit Department. The second line of defence was the way in which the fund managed its risks. As will be discussed later, Fund A set up its risk management function recently to address different types of risk, including corruption and fraud risks. The third line of defence was the Internal Audit Department. The core business departments were reviewed by the Internal Audit Department annually, whereas the support departments, such as HR, were reviewed once every two to three years. The main function of the internal audit was to assess compliance with policies and procedures and report breaches of these to the board. This task was complicated by the fact there were grey areas of interpretation of the policies and procedures⁷⁴. For example, if Project A made an application for a loan, and then Project B made a separate application for a loan, but the success of Project A was wholly reliant on the success of Project B (and vice versa), the Internal Audit Department could argue that these two projects should be considered as one application. However, if the director general interpreted this as being two separate applications, he could approve this, even if the total of the two applications exceeded the limits put in place in the fund's policies and procedures.⁷⁵ If this sort of breach was found during an audit, but the applications had already been approved by the director general, the Internal Audit Department would not include these in their report as this would have been seen by the director general prior to the report being sent to the board of directors⁷⁶.

The first and second lines of defence against corruption mentioned in the previous section showed the ultimate responsibility for them residing with the director general. However, the third line of defence was considerably weaker than it should have been within Fund A because the Internal Audit Department did not report directly to the board. With the director general having sight of all reports to the board from internal auditors, Fund A's reputation for being relatively incorruptible was reliant on the

⁷⁴ Personal communication with interviewee 14

⁷⁵ Personal communication with interviewee 13

⁷⁶ Personal communication with interviewee 14

director general being clean. If this were to change, there would no longer be any effective defences against corruption within the fund.

Allowing the Internal Audit Department to report directly to the board would have given the board oversight of how the director general managed anti-corruption policies within the fund. As things stood, the board only had this oversight because the director general allowed this by passing internal audit reports without editing them. If the director general was to become corrupt, the board would only rely on external audit reports as well as the fund's reputation among the business community.

Reporting lines were important, as this was the most effective tool with which the board could oversee the potential for corrupt practices within the fund. In Fund A, as interviews with a number of internal auditors showed⁷⁷, there had never been a clear breach of policies and procedures by senior management that could be seen as corruption, but this was because the current and previous director generals were considered clean. However, if a director was involved in corrupt practices, the reporting lines from the Internal Audit Department to the board, via the director general, would be largely ineffective in reducing corruption as the director general could prevent such a report from being seen by the board. Therefore, there was potential for corrupt practices by the director general within Fund A because of their reporting lines.

This issue could potentially be exacerbated as the director general had the power over the Internal Audit Department to reward bonuses, recommend staff for promotion, and authorise training for the internal audit staff. Any internal auditors wanting to criticise the director general in a report would know this and would know that he would see a critical report. Therefore, there was likely to be a degree of self-censorship by internal auditors because they would be aware that any report critical of the director general would be edited or suppressed before the board of directors saw it, and that the director general could negatively affect the internal auditors' chances of promotion or receiving a bonus; hence, internal auditors were far less likely to include criticism of the director general in their reports.

However, having the Internal Audit Department report to the director general may have been advantageous in other ways. As the Internal Audit Department in Fund A reported

⁷⁷ Personal communication with interviewees 13 and 14

to the director general rather than directly to the board, the director general empowered the Internal Audit Department to look for serious forms of corruption; whereas if they reported directly to the board, the director general could see them as a potential threat to him and could use his influence to marginalise the entire Internal Audit Department by putting obstacles in their way (for example, limiting or delaying their access to certain documents and information), thus rendering them powerless to carry out a proper audit of the organisation. This was consistent with previous research into the effectiveness of Internal Audit Departments in the Saudi public sector, which concluded that the most important factor in having an effective internal audit was having proper support from senior management in government organisations (Alzeban & Gwilliam, 2014).

3.3.7.3 Limiting authorities and responsibilities

Within Fund A, responsibilities and their limits were clearly defined. Delegating authority gradually may play a role in curbing corrupt practices, so delegating authority as trust increases is likely to help in preventing corruption. For example, the board initially limited the director general's discretion to approve loan applications up to USD 4 million, but by 2013 had gradually increased this limit to USD 8 million. This change was brought in as a direct result of the board's review of management's limitations of authorities and responsibilities and having those altered to appropriate levels⁷⁸. Even in cases where the director general had the discretion to approve a loan, he had to submit a report to the board detailing all approved loans and disbursement of funds. This empowerment of the director general was very helpful in curbing corruption amongst his staff and was evidenced by: having all departments, including the Internal Audit Department, reporting to and supervised by the director general; giving the director general responsibility over recruitment, promotion, training, scholarship, bonuses, and annual pay increments; and empowering the director general to propose any amendments to policies and procedures, including the internal audit charter.

As well as having clear definitions of the responsibilities of the director general, Fund A had well documented policies and procedures to establish the authorities and their

⁷⁸ Personal communication with interviewee 12

limits for all officials, the most important of which was the credit policy guide which governed Fund A's core business.

Several respondents⁷⁹ highlighted the benefit of having a clear credit policy guide since the establishment of the fund, which defined the responsibilities of each individual in the process (starting from front desk officials, through the Credit Department and to senior management and the board of directors) whilst at the same time limiting the discretion of all staff (including senior managers) to making decisions within certain areas. This played a role in minimising corrupt practices within the fund, whilst also making the Internal Audit Department's task of checking compliance with the guide a clear and transparent process on an annual basis.⁸⁰

In addition to this, there was a job description manual for all Fund A staff. However, these job descriptions were not updated and were, therefore, not rigidly adhered to throughout the organisation. For example, one accounts auditor was also involved in auditing compliance of policy and procedures of other departments, but his job description did not reflect this.⁸¹ Indeed, the HR Department was aware of this issue and was in the process of updating all job descriptions to reflect the fact that specific roles had been expanded to take on more responsibilities.⁸²

3.3.8 Commitment to Competence

3.3.8.1 Establishing policies and practices⁸³

A number of interviewees stated that Fund A's commitment to recruiting and training competent officials was the most important reason why corruption was low at Fund A. The clearest example of this was the rigidity of the HR procedures and policies which were specifically designed to attract the most competent and honest employees and to remove nepotism and tribal loyalties from the recruitment process. For instance, Fund A did not accept anyone who had below 3.5 out of 5 university degree GPA, nor did

⁷⁹ Examples: personal communication with interviewees 19, 23, and 38.

⁸⁰ Personal communication with interviewee 26

⁸¹ Personal communication with interviewee 16

⁸² Personal communication with interviewee 17

⁸³ This section is based on personal communication with interviewees 39 and 56

they accept anyone who had lower than 450 in TOEFL (or equivalent). In fact, without having achieved these standards, it was impossible to apply for a position. This filtered out a large percentage of candidates who would have liked to apply – maybe as many as 70 per cent.⁸⁴

Fund A has had applicants who exaggerated these scores in their on-line application to try to gain access to the recruitment process; however, candidates were then asked to provide proof before their application could be processed to the next stage. Once it had been established that they did not meet the required standard, these candidates had their application terminated immediately. This part of the recruitment process was carefully checked by the Internal Audit Department to ensure that the minimum educational standards were met by all applicants.

Once the on-line application process was completed and their educational achievements checked, Fund A could then match the best applicants' experience with the relevant open positions within Fund A. The candidates were then interviewed and given a score based on the interview. The interview process involved an initial interview with one of the instructors on the training programme (who is from North America) so that they could be satisfied that the candidates had the necessary abilities to pass the training programme. They were then interviewed by a committee made up of representatives of three different departments.

The interview process was initially carried out by a non-Saudi national from North America, whose only concern was to filter out any candidate they did not believe had the necessary abilities to successfully complete the training programme. The committee stage of the interview process meant that having influence with a person in one department was not enough to bypass the objective recruitment process, as the committee members from the other departments would have their say as to who were the best candidates, which would help to ensure that only the best candidates succeeded.

Once these stages were completed, the scores for GPA, TOEFL, and the interview were combined and the best scoring candidates would be offered a position. The weightings for these were 25 per cent on GPA, 25 per cent on TOEFL, and 50 per cent on interview – so the candidates seemed to be recruited on impartial criteria which were the same

⁸⁴ Personal communication with interviewee 17

for everyone⁸⁵. The objective, quantitative scoring system meant that there were limited opportunities for corruption to let in less able candidates who had power or influence in other areas (*i.e.* through family or government connections), so the whole process was seen as almost incorruptible.

Once candidates had successfully passed the recruitment process, they were offered a position on Fund A's training programme, not a permanent position. This training programme had to be completed successfully as they did not offer anyone a position unless they had completed the training programme in full (six months English language training and six months accounting and finance training in English).

3.3.8.2 Evaluating competence and addressing shortcomings

The process of evaluating competence started at the recruitment process by filtering out those applicants who lacked the necessary skills to attain a position on the training programme. Candidates who did gain a place were only offered a temporary contract and would only be offered a permanent one if they successfully completed the programme. This ensured that all permanent staff had a high level of competence before they even received a permanent job offer.⁸⁶

Fund A had an on-going training programme with an annual budget of USD 22 million.⁸⁷ All officials were expected to attend one or two training programmes a year to maintain the high levels of staff competence. Receipt of an annual pay increment was dependent on an assessment of their performance and competence in an annual review carried out by the employee's manager based on criteria set by the HR Department and approved by the board of directors.⁸⁸

In order to achieve promotion to senior management levels (grade 23 or above), employees in some departments were required to gain globally recognised professional qualifications. For example, in the Internal Audit Department, to reach grade 23,

⁸⁵ There is always a degree of interpretation here. There may not be, for example, agreement on who interviewed most impressively. Human judgement is involved and that can and eventually will mean differences of opinion.

⁸⁶ Personal communication with interviewee 17

⁸⁷ Email from interviewee 57

⁸⁸ Personal communication with interviewee 12

employees must be Certified Public Accountants (CPA) or Certified Internal Auditors (CIA).⁸⁹

From an internal audit perspective, the high levels of professional training and expertise amongst internal auditors meant that they were highly skilled in assessing compliance and uncovering corrupt practices within Fund A. For example, all internal auditors had to complete the intensive training programme, which included working on secondment for seven months with one of the Big Four accountancy firms. Once completed, all internal auditors were encouraged to obtain globally recognised professional certification in the area of auditing and accounting from an institution such as the Chartered Institute of Internal Auditors. Currently, there are 15 people working in the Internal Audit Department, more than half of whom have a US or Saudi certified public accountant qualification, or both.⁹⁰

Within the core business, the training programme and high levels of employee competence meant that employees were more likely to know which practices were compliant with the fund's policies and procedures and which practices were not. This meant that there was a lower number of non-compliant loan applications, so the Internal Audit Department could carry out a thorough investigation into any that breached their policies and procedures. This seems to have increased the internal auditors' ability to uncover a higher percentage of corrupt loan applications within Fund A. In a less competently staffed government agency, the internal auditors would have more breaches of compliance, and it would be harder for the internal auditors to know if this was because of corruption or incompetence. It would also mean that the Internal Audit Department would be stretched, with more breaches to investigate, thereby reducing the opportunity for a thorough investigation into all breaches of compliance.

3.3.8.3 Attracting, developing, and retaining individuals

Fund A's policy with regard to recruitment was to attract and develop the best individuals. This was achieved by having a recognised and respected training programme – so much so that it had been known for candidates to take an initial pay

⁸⁹ Personal communication with interviewees 12 and 29

⁹⁰ Personal communication with interviewee 11

cut to enter the training programme. Fund A was recognised within Saudi Arabia for attracting and training the best individuals. One official stated that “I used to work in.... with a higher salary in comparison to Fund A; yet Fund A’s training programme attracted me to join the fund”⁹¹. Fund A’s vision and mission statement clearly supported HR development, not just for the benefit of the fund but for the Saudi economy as a whole.⁹²

Employing competent and skilful individuals increased the competition between employees to provide the best service and attain the highest incremental increase in salary at the end of the year. This created a culture within the organisation of professionalism and good practice, thereby reducing the incidences of corruption at the fund. This culture of professionalism was started, and continues to exist, as a result of there being a concrete relationship between Fund A and the Western financial institution since the establishment of the fund. To illustrate this, one senior manager stated that:

When I was sent to work on secondment in New York as part of a training programme, there were only three Saudis working with 30 US citizens who are recruited from the best universities.⁹³

Fund A was also committed to employing the best employees both from outside Saudi Arabia and from within. Fund A employed 12 per cent of their employees from outside of Saudi Arabia – mainly high quality candidates from Western countries⁹⁴. As part of the recruitment process, Fund A contacted previous employers for references.

However, employing nationals from Western countries was not an absolute guarantee that these individuals would not be corrupt, nor did employing a national from a developing country mean that they were more likely to accept bribes to pass loan applications.

There was an argument that having Saudis working within an organisation was a protection against corruption. Saudis mainly have to work within Saudi Arabia and being caught and found guilty of corrupt practices would be hugely damaging to their

⁹¹ Personal communication with interviewee 16

⁹² Fund A’s annual report 2013

⁹³ Personal communication with interviewee 22

⁹⁴ Personal communication with interviewee 19

future career as their corrupt practices would be known, thereby making it almost impossible for them to obtain a good job. By contrast, a non-Saudi national, if found to be corrupt, would have their contract terminated but may possibly be able to return to their country of origin and continue their career unharmed.⁹⁵

Previous corruption cases in Fund A might suggest that employing officials from Western countries would not guarantee that they would not be corrupt, and neither would employing officials from countries considered to have high levels of corruption necessarily mean that they would engage in corrupt practices. For example, one employee at Fund A from a developed country (with a Transparency International ranking as one of the least corrupt in the world), who was working in the Technical Department, accepted a bribe from a businessperson to give his recommendation to a project that did not fulfil the fund's criteria for admissibility. Despite this, and because of the rigid checks and balances within Fund A, the loan application was rejected, mainly because of the report from the Credit Department, whose recommendation to reject the loan carried more weight in this particular instance than the (corrupt) report from the Technical Department. The businessperson who paid the bribe subsequently complained that he had made a payment for the loan application to be accepted and, following an internal investigation, the corrupt official was fired from Fund A.⁹⁶

In another example, a national from a developing country (with a Transparency International ranking as one of the most corrupt in the world), working at Fund A, was offered an expensive Rolex watch to write a report recommending a loan application. He refused to take the bribe and reported this to senior management, who appreciated his honest conduct.⁹⁷

In terms of retention, this training programme had its drawbacks. As it was so well recognised and well regarded, and attracted the best, most talented individuals, once the training programme was completed these individuals could command a much higher salary on the employment market and often left to earn higher salaries elsewhere. As such, the staff turnover was very high, to the extent that only a few officials stayed in the Credit Department for more than five years.⁹⁸ This might have played a role in

⁹⁵ Personal communication with interviewee 22

⁹⁶ Personal communication with interviewee 22

⁹⁷ Personal communication with interviewee 22

⁹⁸ Personal communication with interviewee 20

reducing the establishment of a long term relationship between officials and the fund's business clients.⁹⁹ The fact that businesspersons were not able to establish a relationship with Credit Department officials meant that the links with business remained professional and did not become personal, as this was often where bribes would be offered and accepted. Therefore, it could be concluded that having a highly trained and talented workforce, who were greatly sought after by private sector recruiters, reduced the likelihood of corrupt government-business relationships being forged, thus keeping the levels of corruption to a minimum.

The COSO framework regarding this area seemed to suggest that attracting, developing, and *retaining* high quality staff was a control on corruption. However, Fund A's example showed that high turnover of their staff appeared to have played a role in maintaining low levels of corruption. As discussed in section (2.2.3.5), there is an argument in the corruption literature that retaining staff for lengthy careers within an organisation with the same posts could cause corruption rather than prevent it.

3.3.8.4 Planning and preparing for succession

Fund A had a very high turnover of staff as they had a unique training programme, and their staff were well regarded within the banking sector, which could offer higher salaries than the government. Fund A did have some safeguards against staff leaving immediately upon completion of their training programme; for example, if sent overseas for two years as part of their training (usually to the USA or Canada to work and train with a Western bank), they would sign a contract tying them to Fund A for a further two years upon their return. They were not permitted to complete the two-year placement abroad and immediately leave to work in the private sector, so Fund A benefitted from the training they had provided for at least this two-year period¹⁰⁰. Another safeguard was the recognition that many of the officials working within the

⁹⁹ Bribes often pass between people who know each other well. Too risky to mention bribery with someone you do not know well. So, staff-rotation does make sense from this perspective (Rose-Ackerman & Palifka, 2016).

¹⁰⁰ This paragraph and the following two paragraphs are based on personal communication with interviewee 39

Credit Department would leave the organisation within five years, so there was a continuous recruitment process.

However, once a Fund A official decided to stay with the fund and was promoted to senior management levels, they were likely to remain for a long period of time, so the level of staff turnover at higher pay grades was much lower. This caused a different problem in that there was too much knowledge in the hands of a very few members of the senior management team. This meant that once they retired, their knowledge could be lost to the organisation for good and so a proper succession plan would be necessary to prevent this.

Apart from the effects of staff rotation, it was unclear whether there was a link between Fund A's lack of succession plans and its low levels of corruption.

3.3.9 Accountability

3.3.9.1 Enforcing accountability

All Fund A staff were held accountable for any actions they took that breached the internal control policies of the organisation. This was clear to, and well-known by, almost all the staff. The lack of tolerance by senior officials of corrupt practices was backed up by appropriate action when these practices were uncovered, usually by whistleblowers' reports or a thorough investigation. The action taken led to dismissal from the organisation at the very least. However, senior Fund A officials were not keen to publicise these investigations and a culture was created whereby the existence of corrupt practices was not recognised for fear that publicising the existence of corruption within the fund would normalise such behaviour and encourage it to become more widespread. For example, interviews with employees with less than five years at Fund A showed that all of them were unaware that there had been any corruption cases within the fund in the past. However, senior officials admitted that there had indeed been a number of cases of corruption.¹⁰¹

¹⁰¹ Personal communication with interviewee 22

The culture of non-tolerance of corrupt practices within Fund A, and the holding of officials to account for their actions, could be seen as an effective deterrent against corrupt practices within the organisation. If senior managers were seen to be free from corruption and imposed this accountability on their staff, then corruption should be kept to low levels. However, by not publicising the fact that corruption was not tolerated, the management may not have been as effective in this regard as they could have been. If employees were unaware that corruption was punished when uncovered, the deterrent of this punishment might be lost as officials, wrongly thinking that corrupt practices go unpunished within Fund A, might decide that there was no downside to being corrupt and so act in a corrupt manner.

Furthermore, Fund A was not perfect in other areas of corruption. For example, the lunch break was between 12.30 and 1.30. However, with prayers beforehand, and a slack enforcement of the time officials were due back to work, most staff actually took a break from 12.00 until 2.00.¹⁰² This practice was widely tolerated within the fund, despite their rigid adherence to most rules and regulations in all other areas. The management justified such tolerance because it helped to motivate staff to carry out their duties more professionally rather than just ensuring that all officials were at their desks for the exact number of business hours.¹⁰³ One official argued that this approach worked as many officials worked extra hours in the evening without claiming overtime, as a result of being given more time off at lunch than their contract stipulated.¹⁰⁴

3.3.9.2 Evaluating performance and incentives

Fund A had a policy of performance-related pay for its officials. The performance of officials was evaluated against pre-set criteria, and the percentage increase in annual pay was based on how the official performed against these criteria. Included in the pre-set criteria were their knowledge of policies of procedures and how compliant their work was with these policies and procedures, which indirectly covered ethical working practices as some policies dealt with conflicts of interest. Fund A officials were

¹⁰² Personal observation confirmed by personal communication with interviewee 32

¹⁰³ Personal communication with interviewee 28

¹⁰⁴ Personal communication with interviewee 21

evaluated on an annual basis and the results of this evaluation were used by management to reward officials with a pay rise, which could be up to 10 per cent.¹⁰⁵

As Fund A had low levels of corruption within the organisation, this evaluation appeared to have the desired effect, incentivising individuals not to partake in corrupt practices but instead to earn a pay rise by acting competently and ethically. For example, if an official working on a loan application for a client came across a grey area in the application, they may be tempted to process the loan despite this grey area in order to obtain favours from the client in the future. However, if the official had an incentive to process the loan ethically (as they do in Fund A because it could affect their pay rise), then they were more likely to do so.

Evaluating the performance of individuals in relation to their awareness of policies and procedures and their compliance with these, and rewarding them for good performance in this (and other) areas seemed to be carried out well within Fund A. Despite the fact that standards of ethical behaviour were not evaluated because they had no official code of conduct, the levels of corruption were low. The institutional incentives to perform well and not take short cuts to hit targets, or bribes to favour certain loan applications, appeared to be at an effective level within the organisation, and appeared to help to reduce the amount of corruption that occurred.

However, when implementing performance related pay structures, it was possible to reward officials for applying too rigid an interpretation of policies and procedures. To illustrate this, one official within Fund A was well known for his high level of attention to detail – scrutinising credit applications and rejecting many for not meeting certain criteria. For example, Saudi companies had to employ a certain percentage of Saudi nationals in accordance with directions from the Ministry of Labour. This particular official rejected applications because there was not a sufficient percentage of Saudis working on the project for which the loan was intended, not on the basis of the company as a whole, even though the number of Saudis employed by the loan applicant was sufficient as per the Ministry of Labour's requirements. This level of scrutiny was considered a good thing by management as it showed his eye for detail, however the loan should have proceeded as the loan applicant did in fact employ a sufficient number

¹⁰⁵ Personal communication with interviewees 12, 17 and 21

of Saudi nationals to qualify. This loan could have allowed a project that would benefit the Saudi economy to be approved, yet it was rejected on grounds that appeared to be subjective to the credit analyst. Nevertheless, this official was deemed an effective credit analyst and received his pay rise.¹⁰⁶

One area of disagreement between interviewees was the evaluation of an official's performance against a code of ethics. One official stated that such evaluation would be very subjective, questioning the validity of such assessment, including evaluating someone against taking a bribe. However, it was suggested that the assessment could be carried out by employing an *agent provocateur*.¹⁰⁷

Using *agents provocateurs* could be considered unethical (and in some countries illegal) as, if used incorrectly, they might encourage corruption that would otherwise not have taken place. Employing *agents provocateurs* could create an atmosphere of distrust within the fund, which could lower morale and therefore lower performance.

3.3.9.3 Considering excessive pressures

Although Fund A did not have KPIs for individuals or departments, pressure still existed in the Credit Analysis Department as there was a very tight timescale for processing loan applications, in addition to which analysts were expected to scrutinise the applications in great detail¹⁰⁸. These goals could be seen to be in conflict as effective scrutiny was a time-consuming exercise which ate into the rigid time targets for processing the applications. Despite this pressure, there was very little corruption within Fund A and the pressure on officials did not appear to have increased the level of corruption within the fund. In fact, the adherence to such a tight timescale might have reduced corruption as loan applicants were not likely to bribe officials to make a speedy decision as it would be pointless – the applications were invariably dealt with in a speedy manner anyway, without the need to bribe any corrupt officials.¹⁰⁹

¹⁰⁶ Personal communication with interviewee 31

¹⁰⁷ Personal communication with interviewee 11

¹⁰⁸ Personal communication with interviewee 21

¹⁰⁹ Personal communication with interviewee 23

Summary of Soft control Anti-corruption Strategy

The following table provides a brief assessment of the research findings based on the discussion in the above chapter, utilising the COSO framework's categorisation of the control environment.

Table 3.1
The effectiveness of Fund A's soft control in tackling corruption

| Internal control elements | Contribution to Fund A's Agent low corruption | Contribution to Fund A's Sub-agents low corruption |
|--|--|---|
| <i>Commitment to integrity</i> | | |
| Setting the tone at the top | High | High |
| Establishing standards of conduct | Low | Low |
| <i>The board exercised oversight responsibility</i> | | |
| Establishing oversight responsibilities | Medium | N/A |
| Applying relevant expertise | Medium | N/A |
| Operates independently | Medium-High | N/A |
| Providing oversight of internal control | Medium-Low | N/A |
| <i>Establishing structure, authority, and responsibility</i> | | |
| Hierarchical management structure | Medium | High |
| Establishing reporting lines | Low | High |
| Limiting authorities and responsibilities | Medium-Low | Medium-High |
| <i>Commitment to competence</i> | | |
| Establishing policies and practices | Medium-High | High |
| Evaluating competence and addressing shortcomings | Medium-High | High |
| Attracting, developing, and retaining individuals | High | High |
| Planning and preparing for succession | Low | Low |
| <i>Accountability</i> | | |
| Enforcing accountability | High | High |
| Establishing performance measures, incentives, and rewards | Medium-Low | Medium |
| Evaluating performance and incentives | Medium | Medium-High |
| Considering excessive pressures | Low | Low |
| Overall assessment of internal control | Medium | High |

3.4 HARD CONTROL ANTI-CORRUPTION STRATEGY

The section on hard control anti-corruption strategy includes in-depth analysis of Fund A practices on risk assessment approaches, internal control activities, and information and communication. Within the analysis of each practice, the research links each one of these practices to Fund A's low level of corruption.

3.4.1 Risk Assessment

This section discusses how Fund A developed its risk assessment approach, starting from setting up its vision and mission, through to the setting of its objectives, and analysing risks that might adversely affect the achievement of those objectives - in particular, identifying the risk of fraud and corruption.

3.4.1.1 Identification of objectives

As stated by the COSO framework “a pre-condition to risk assessment is the establishment of objectives” (Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013, p. 59). Fund A, in common with many other Saudi government agencies, had a mission statement and vision which the organisation as a whole worked towards. In order to achieve this vision, objectives were set, and as a result of these objectives, risks against meeting them were identified and assessed. Fund A's vision, as quoted in its annual report of 2013 and on its website, is “To continue as a leader in financing [its]... sector and supporting economic and HR growth in the Kingdom of Saudi Arabia, and to be recognised globally as in this field.”¹¹⁰ The fund specified its objectives as a whole, which reflected the management's choices in terms of structure, risk tolerance, financial performance goals, and allocation of resources. However, the way it presented its objectives did not follow the format set out in the

¹¹⁰ To protect the anonymity of Fund A, the research does not show in which sector it operates. The vision statement was translated from Arabic to English.

COSO framework, *i.e.* differentiating between its operational, reporting and compliance objectives.¹¹¹

Prior to 2014, there were no clear objectives to tackle corruption, mainly because the executive management did not think corrupt practices were an issue that needed to be tackled within Fund A. This was evidenced by the fact that the number of corruption cases found in the fund was close to zero, with very few complaints of corrupt practice that might have triggered the need for a more robust approach to corruption. Moreover, the fund had an enduring reputation as an organisation that was free from corruption, and was well known and highly regarded for its professionalism.

However, as part of the on-going process of improvement within Fund A, an external multi-national consultancy firm (one of the “Big Four”) was hired to assess and evaluate the strategic direction of the fund. One of the recommendations from this process was the establishment of a risk management unit. This unit was established in 2014 and an expert consultant from a developed country, with more than 30 years of experience in a number of multi-national businesses, was hired to head it. This appointment led to the introduction of eleven categories of risk management guidelines including: credit risk, human capital people risk, finance capital and funding risk, technological risk, legal risk, social responsibility, sustainability, and reputational risk.¹¹²

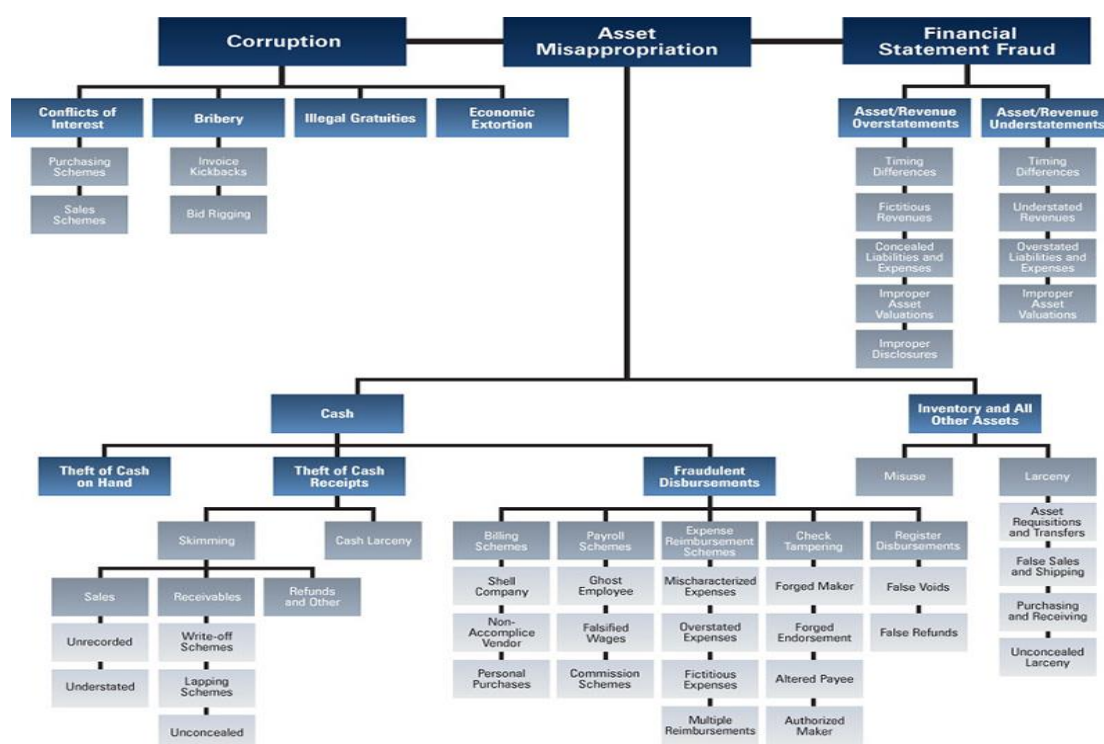
Part of reputational risk is the fraud and corruption risk management guideline. This guideline adopted the following fraud tree as developed by the Association of Certified Fraud Examiners, identifying potential sources of internal fraud and corruption.

¹¹¹ This paragraph and the subsequent two paragraphs are based on personal communication with interviewee 12

¹¹² Personal communication with interviewee 31

Figure 3.2

Fund A's Fraud Tree



Source: Fund A's manual citing The Association of Certified Fraud Examiners (2015)

The main objectives of Fund A's fraud and corruption risk management guideline were to:

ensure that Governance and Leadership arrangements related to the risk of fraud and corruption are adequate...develop a strategy for the management of significant potential fraud or corruption exposures...develop a robust approach to the identification, analysis, evaluation, and treatment of significant fraud and corruption exposures...develop performance criteria and performance monitoring indicators to measure success in identifying, prevention, detecting, measuring, managing, and reporting exposure to fraud and corruption.¹¹³

In short, Fund A only introduced clear objectives to address the risk of corruption in 2014, yet even prior to this its level of corruption was low. Therefore, having these objectives were not a pre-requisite to low levels of corruption if other controls, both soft and hard, were effective in preventing and/or detecting corruption. However, it

¹¹³ Fund A's fraud and corruption risk management guideline

could be said that having these objectives will help an organisation to more efficiently manage and mitigate its systemic corruption risks.

3.4.1.2 Identification of risks to the achievement of objectives

Up to 2014, the fund did not have any clear mechanism to identify risks associated with the achievement of its objectives, and several interviewees seemed unaware of their department's objectives. The role of the Internal Audit Department was to identify risks arising from loopholes within Fund A policies and procedures. In other words, their role was a compliance audit, rather than trying to achieve the objectives of the fund. The assumption was that if every official correctly implemented the organisation's policies and procedures, which were updated periodically, then the overall objectives of the fund would be achieved¹¹⁴. However, this assumption was proven to be mistaken because the fund financed projects that were deemed to be low risk so that the loans would almost always be paid back, but some higher-risk-higher-reward projects were rejected, even though the success of those projects (if achieved) would have made a greater positive contribution to the Saudi economy as a whole in comparison with the low-risk-low-reward projects that were financed. In other words, the fund acted more like a commercial bank than a government fund set up to support projects that would add more value to the Saudi economy. This could be explained by the fact that the fund and its policies and procedures were set up with the help of a Western commercial bank.¹¹⁵

Subsequent to 2013, the fund started its risk management unit, which identified objectives for all departments, in line with the COSO framework. The risk management unit considered external and internal factors that might hinder the achievement of the fund's objectives; it then prepared a risk management guideline. This guideline addressed eleven categories of risk, which included estimating the significance of each risk, and then determined how it should respond to these risks.¹¹⁶

¹¹⁴ Personal communication with interviewee 11

¹¹⁵ Personal communication with interviewee 31

¹¹⁶ Personal communication with interviewee 31

It is unclear if there was a link between the lack of adopting the risk assessment approach to achieve the funds objectives in general and the levels of corruption, as these were at low levels prior to the risk management framework being implemented and remained low after its adoption.

Fund A adopted a risk assessment approach to ensure that all officials complied with its manuals and procedures, but not to ensure that Fund A achieved its objectives. Therefore, one could conclude that a risk assessment to achieve its objectives aimed to increase the fund's efficiency and how well it managed its resources, rather than to reduce corruption. This is evident in the fact that Fund A had a low level of corruption, but at the same time its efficiency was questioned by Western experts.

3.4.1.3 Addressing corruption risks

Fund A did not have specific objectives to tackle corruption, therefore no risk assessment was carried out to achieve its objectives *per se*. Instead, Fund A conducted risk assessments to ensure that everyone complied with its policies and procedures. In their risk assessment, the fund's internal auditor seemed to be more focussed on everyone's compliance with policies and procedures and in safeguarding the fund's assets, which indirectly mitigated corruption risks. For example, the internal audit noticed that there were no CCTV cameras in the warehouse to protect the stock from theft; their attitude was that installing cameras would prevent the stock from theft from outside the organisation, but they had not even considered that the stock could be stolen by officials from inside the organisation (embezzlement).¹¹⁷ Nevertheless, the cameras would have acted as a deterrent of corruption from inside the organisation.

Starting from 2014 Fund A carried out a more strategic approach to tackling corruption by adopting the fraud tree which was developed by (The Association of Certified Fraud Examiners, 2015). Under this tree, corruption was divided into four areas: bribery, conflict of interest, illegal gratuities, and economic extortion. By adopting the Association of Certified Fraud Examiners fraud tree, one would expect that the fund would assess incentives, pressures, opportunities, attitudes, and rationalisations to

¹¹⁷ Personal communication with interviewee 15

engage in or justify corrupt practices. However, Fund A did not seem to address or consider these factors when assessing the risk of corruption; instead they considered corruption on three levels – for instance, under bribery there were further categories, such as “invoicing kickbacks” and “bid rigging”. Furthermore, Fund A categorised corruption risk assessment by process level. To illustrate this, the risk management guideline states that in the loan approval process, an employee in a position of authority could override a rejected application and approve it to the benefit of both the applicant (who receives a cheap loan) and the official himself (who receives financial reward from the applicant for approving the loan).¹¹⁸

The main indicator for assessing corruption risk was being non-compliant with legal and regulatory obligations from a perspective of fraud and corruption. Fund A’s risk appetite document states that “the fund requires full compliance with relevant laws and regulation”.

Fund A had five levels of risk tolerance/levels of consequence, starting from level 1, which was “All relevant laws and regulations identified and process/system capabilities assessed as adequate. No legal or regulatory issues insignificant or inconsequential to the fund”, through to Level 5, which was “significant prosecution of the fund, its directors, or employees. Very serious breakdown in relationship issues with major stakeholders...Suspension of the fund’s activities; fines, class action or other criminal penalties likely; very significant adverse media publicity (e.g. global) occurring or likely”.

The risk management guideline for Fraud and Corruption first identifies all relevant anti-corruption laws and regulations; then it provides definitions of the key legal terms, *e.g.* bribery and public official; finally it clearly spells out the consequences of corruption, stating that “Penalties under the Bribery Regulations include fines not exceeding SAR 1 million [USD 266,000] or imprisonment for a period not exceeding 10 years, or both. These may be imposed on either or both the person offering or making and the person requesting or accepting, a bribe”. The guide even goes as far as to explain practices which would be considered corrupt in developed countries, but which are not crimes in Saudi Arabia, such as paying bribes to foreign public officials, stating that:

¹¹⁸ This paragraph and subsequent paragraphs are based on Fund A’s fraud and corruption risk management guideline from page 3 to page 10.

“There are no laws prohibiting or regulating the corruption of public officials in other countries”. This shows that the officials who compiled this document were working from a checklist that addresses corruption from a Western perspective, not just from a Saudi perspective. For instance, the guideline addresses items such as political contributions, and facilitation payments. In this regard, the guideline states that “There are no political parties in Saudi Arabia” and “There are no statutory exceptions for, or limitations on “facilitation expenses” which exempt them from the definition of bribery, either public or private. Each expense must be evaluated on its own and with consideration to the surrounding facts in order to judge whether it is likely to be considered a bribe”.

Fund A’s approach to reducing and eliminating violations of its practices and procedures would not necessarily eliminate corruption, even if the breaches were reduced to zero. This is because there were loopholes in all practices and procedures that could be exploited by corrupt individuals. The counter-argument to this is that there is no better way of objectively measuring, and therefore improving on, levels of corruption than this approach, and that organisations should strive to eliminate breaches of practices and procedures in order to reduce levels of corruption. Officials within Fund A would point to the low levels of corruption and their organisation’s reputation as proof that this approach was the most effective. If the terms were laid down, then the expectations of the employees would be clear and it would help them to be compliant.¹¹⁹

Although Fund A had developed its very comprehensive risk management guideline, which included corruption scenario analysis, it seemed that there were disagreements regarding whether some practices that the guideline deemed to be corruption were in fact so. For example, in the travel expense process, one corruption scenario was identified as follows: “Excess expense claimed (*e.g.* business class) is not that incurred (*e.g.* economy) to benefit the fund employee”. From the perspective of a Western interviewee, this practice would be considered corruption as the employee would be considered to have made a false expenses claim for more money than he was entitled to. Some Saudis would support this argument, stating that if he were entitled to take a business class flight then the official should take it so that he would arrive at his business meeting feeling refreshed and relaxed, having benefitted from the additional

¹¹⁹ Personal communication with interviewee 25

services received from a business class flight compared to an economy ticket. However, many Saudis would not consider this to be a corrupt practice as the official was entitled to a business class ticket, but decided to fly economy and pocket the difference. Therefore, he would not be receiving anything over and above what he was entitled to, but was receiving the same benefit in the form of a cheaper and lower quality flight plus the difference in cash. It should be noted that there is nothing in this arrangement that contravenes Saudi law. Having no policy to prevent officials from cashing expensive tickets and booking cheaper flights led to another, similar practice being carried out by some Fund A officials in that they would often claim for indirect flights to a destination. As illustrated by one official,

When a senior manager had a training programme in London, he would sometimes book a flight to London via Paris, then return from London via Istanbul to Riyadh, claiming for first class tickets for all four legs of the journey... [Once the expense claim for these flights has been approved, this manager would then claim the money from the travel agent and book a cheaper direct flight to London and pocket the difference in cash]... This practice is inefficient and wasteful use of government fund.¹²⁰

3.4.1.4 Identifying and analysing significant change

Fund A did not assess changes in the external environment, nor changes in leadership, simply because neither of these factors had changed – the executive management team had been together for more than 25 years and the director general had been at Fund A for 37 years.¹²¹

Having a senior management team working together for such a long time could be seen as a double-edged sword. On the one hand, if a management team is incorruptible and has worked together for a long period, they can collectively reduce or eliminate corruption, which appears to have been the case within Fund A. On the other hand, management working together for such a long period could create opportunities for collusion, and therefore they could become expert at hiding corruption from external

¹²⁰ Personal communication interview 7

¹²¹ Personal communication interview 31

scrutiny, as it would be easy for them to override any internal controls on corrupt practices. As explained by one official:

The overall experience of corruption was low ... but it's just that's the way it's happened. They don't actively go and manage this risk. I think it has just happened that way...Are they just inherently conservative, the types of people that have been in management positions over the years? And, they haven't changed very much, have they, because the director general has been here 37 years...They have, collectively, I think they... a lot of them actually were in the same intake and they've all been together forever [laughter]...So, their culture has been developed over a long, long, long period of time, and maybe it does date all the way back to, sort of, the very early days of the fund, and they're highly unlikely to change that culture. And, that's where, basically, the control, in terms of prevent corrupt practices, sits. It may be that that entire setup was completely corrupt; they're just good at hiding it [laughter]....How could they corrupt things? I mean, collectively, they know each other so well. If they, collectively, wanted to basically pass certain types of project through and improve them, they would.¹²²

The one factor that had changed was the business model, which had been modified in some areas – for example, the fund now offered banks (planning on lending to small or medium enterprises in certain sectors) a guarantee that any loans that were defaulted on would be paid back to the bank in full by the fund.¹²³ Changes in the business model might create opportunities for increased corruption, as it could take time to develop effective internal control that might close loopholes in any new processes. Yet this did not appear to be the case within Fund A. Since the change to offering guarantees to banks' lending to certain small and medium-sized enterprises was introduced in 2006, this programme had offered more than 7,280 loan guarantees, of which less than 1 per cent of guaranteed loans have been defaulted on. Indeed, this guarantee programme was, in 2013, recognised as the best scheme supporting the development of small and medium enterprises throughout the Arab world.¹²⁴

3.4.2 Control Activities

Based on the COSO framework, Fund A's soft control strategy was evaluated, including the following elements: commitment to integrity, board independence and

¹²² Personal communication interview 31

¹²³ Personal communication interview 38

¹²⁴ Fund A's annual report 2013

oversight, recruitment and training, and accountability. Next, an assessment of Fund A's risk management practice was undertaken. This focused on how well the management specified Fund A's objectives and identified risks associated with achieving these objectives – including assessing the risk of corruption and major changes in leadership and the organisation's business model. The following section assesses the activities that Fund A undertook to mitigate these risks, including the quality and enforcement of policies, procedures and board and management directives, segregation of duties, and any alternative control activities specific to Fund A.

3.4.2.1 Control activities to mitigate risk of corruption

Based on Fund A's compliance risk assessment, several control activities were introduced to mitigate the risk of corruption, as stated by one official: Fund A takes precautionary measures to treat the causes of corruption, rather than the symptoms. For example, the loan application process has a timetable for progressing the applications which was strictly adhered to. This was because any delays to an application might encourage a businessman in a hurry to obtain a loan from the fund to attempt to bribe an official to speed up the process. As the applications were dealt with swiftly, there was little point in taking the risk of bribing an official in this way as the application will be dealt with as quickly as possible in any case. In fact, Fund A staff tend to process loan applications more quickly than the procedures demand of them.¹²⁵

However, Fund A's risk assessment was not comprehensive enough to cover all gateways to corruption. For example, it had no safeguards against a "revolving door" between the organisation and the private sector. There was nothing to prevent an official working with an organisation on a loan for a project, then – once the loan had been approved – resigning from Fund A to take up a position at the beneficiaries of the loan. However, the board were aware of this problem and were starting to take action to introduce policies to prevent this from happening.¹²⁶

The lack of a policy in place to prevent the 'revolving door' between Fund A officials and their client organisations was a potential source of corruption. An official could be

¹²⁵ Personal communication with interviewee 23

¹²⁶ Personal communication with interviewee 39

persuaded to look favourably upon a particular loan application with the promise of a lucrative position with the loan applicant once the loan had been approved. This was nothing short of a bribe, but would be difficult to prove. However, revolving door did not appear to be an issue in Fund A as most officials who resigned joined the financial sector which could offer them better remuneration than Fund A's loan applicants. Yet, it was noted that many Fund A officials in the Credit Department were from rich families who had active loans with the fund.

3.4.2.2 Examples of internal control activities

Transparency

Although Fund A published very simple guidelines on its official website regarding how to benefit from its services, there was very little transparency over document sharing, including its credit policy guide and HR manuals. This was one of the major obstacles for this research as most interviewees refused to share any of the fund's official documents, fearing accountability from their superiors.¹²⁷ One senior manager stated that, "We developed the habit of not sharing Fund A's documents with outsiders because this is what we were trained to do by... [the Western bank]."¹²⁸

The lack of access to the credit policy guide led to some former Fund A officials setting up lucrative consultancy practices, offering their services to the private sector for help with applying for loans from the fund. Due to their advantageous inside knowledge of the credit application process, they were able to market themselves as being far more likely to have successful loan applications than consultants without this insider knowledge. In many cases, the fees these consultants attempted to charge were linked to the reduced interest rate of the loans that they successfully applied for in comparison with the interest rate that the firms could borrow from banks. This prompted Fund A to contact all these consultants to inform them that if they continued charging fees based on these reduced interest rates their loan applications would be automatically rejected.

¹²⁷ Some senior managers seemed unhappy with the director general's permission giving me access to view all Fund A's policies and procedures in his office, so they started to delay providing the director general's office with the required documents.

¹²⁸ This paragraph and the subsequent paragraph was based personal communication interview 22

When asked why former officials were allowed this advantage, Fund A officials suggested that these consultants did not have up-to-date versions of the credit policy guide and having out-of-date versions was not that much of a commercial advantage to them¹²⁹. Yet, this was not a very convincing reason as former officials could ask current officials for up-to-date versions because they knew each other very well. This would be a form of corruption as there were clear restrictions on sharing the credit policy guide to those outside the organisation and therefore doing so for an ex-colleague is a form of favouritism.

Checks and balances (separation of power)

The way Fund A set its checks and balances played a major role in minimising the level of corruption as each transaction had to be checked or reviewed by different officials from different departments to comply with Fund A's manuals before and after the final approval was obtained. This limited opportunities for corruption, as officials feared that any corrupt practices which arose from violating Fund A's manuals for personal gain were likely to be red flagged by their superiors or officials from other departments.

One of the most important checks and balances was the regularity with which internal auditors checked the compliance of officials in every department with the policies and procedures that governed their work. For example, in order to prevent conflict of interest between officials in the Credit Department, the credit policy guide stated that all loan applications should be initially checked and screened by the Customer Service Department before being allocated to the credit team best suited to carry out a thorough analysis. The credit analysts therefore did not choose which applications they analysed, and so any potential conflict of interest could be prevented. During an internal audit, compliance with this measure was checked to ensure that credit analysts were not selecting their own applications in contravention of the credit policy guide¹³⁰. This procedure would be carried out by crosschecking the surname of the applicant with the surnames of the members of the team to ensure that family or tribal loyalties could not be allowed to override the objectivity of a decision to authorise the loan. In addition to

¹²⁹ Personal communication interview 26

¹³⁰ Personal communication interview 16

this, if a member of the team suspected that there might be a conflict of interest between the objective analysis of the loan and family/tribal loyalties, they were expected to declare this to the management. Credit analysts were expected to adhere to this from their first day in the job, and it was ingrained in the organisation; it was expected behaviour¹³¹. However, although usually it was easy to ascertain whether someone belonged to a tribe and thus identify any potential conflict of interest, sometimes it was more difficult to determine a link as some tribes were very large in numbers (*i.e.* tens of thousands) and had many people working in the same government department.

However, some officials complained that Fund A placed too much emphasis on checks and balances, as every loan application had to pass a thorough investigation from different officials from different departments. One official stated:

Ironically, one of the biggest strengths is its over-bureaucratic approach, making it such that there are so many signatures on every single piece of paper.¹³²

Another official indicated that

Fund A needs to relax its separation of power and get all experts on one team. This would reduce the time required to process each loan application.¹³³

One drawback of having too many people involved in approving each loan application was negligence arising from officials relying on each other to read the loan applications with all the supporting documents and ensuring their compliance with all relevant policies and procedures. One official commented on having too many signatures in each report as follows:

It doesn't necessarily mean those signatures are effective in any way. I mean, does anybody understand or read them? So, my point here is that there might be lots of signatures, but do people actually read and understand what is actually in front of them. On the one hand, you could say that with the need for all these signatures, there should be layers and layers of additional control and oversight which would make it very difficult for a loan to get through. But, if nobody is reading those things then it becomes a bit of a nonsense...

What should be a great strength is the quality of the project evaluations themselves... There is a lot of work to be done on that in terms of streamlining and getting rid of all the duplication... So, it all ends up in this report which is

¹³¹ Personal communication interview 21

¹³² Personal communication interview 31

¹³³ Personal communication with interviewee 17

impenetrable, very difficult to read, duplicative in nature, and you don't know where the information that you're looking for is¹³⁴.

A further weakness in Fund A's rigid checks and balances was that small and medium enterprises were given limited opportunity to obtain any benefit from the fund as a result. As stated by one Fund A official:

Credit management over-controls their process. The fund was a lending institution and lending institutions factor in some risk, knowing that some of their lending will not be repaid but looking at their portfolio as a whole. Fund A runs the fund as a quasi-governmental institution, not-for-profit. Fund A nails down lending to such an extent that they never want to make any losses. There should be freedom to take more risk and take a few of the controls away... in order to achieve the strategic objectives of the fund, which was strengthening the Saudi economy.¹³⁵

3.4.2.3 Control activities over technology

When the Western bank established Fund A, they established their own IT systems for HR, finance, and other support functions. All the IT programmes stand alone, they are not integrated with each other. At the time of establishment, these IT systems were considered state-of-the-art.¹³⁶ However, since 2005 the Saudi government has invested heavily in IT systems for all ministries as they were able to increase budgets due to hugely increased revenue from oil exports. This allowed them to catch up and overtake the increasingly obsolete systems operated by Fund A¹³⁷ (which was a semi-independent government agency), which were not improved at the same rate and so fell behind¹³⁸. This could be attributed to a conservative attitude amongst Fund A officials, many of whom had worked in the organisation for a number of years, resisting technological change on the grounds that improvements were not needed and the

¹³⁴ Personal communication interview 31

¹³⁵ Personal communication with interview 31

¹³⁶ Personal communication interview 24

¹³⁷ It should be noted that Fund A's accounting system was still considered one step ahead of most government agencies' as the entire accounting cycle was automated. "Documents such as payment vouchers are printed by the system, then signed by Fund A officials... They [Fund A's IT Department] are working now to have electronic signatures" stated one external auditor. Personal communication interview 7.

¹³⁸ Personal communication interview 25

manual loan application process worked well. As a result, Fund A's IT systems were no longer state-of-the-art, and were considered out-of-date.¹³⁹

As Fund A had a number of manual processes that were not automated, including the loan application process, one would expect there to have been more scope for corrupt practices as their officials had more discretion and more opportunities to act corruptly than organisations that had fully automated core business processes. Yet, as Fund A was deemed to have the lowest level of corruption among Saudi government agencies, this was not the case, and a fully automated business process is not a guarantee that corruption levels will be any lower than those agencies that use manual processes.

3.4.2.4 Rigidity of enforcement of policies and procedures

Fund A had a number of policies and procedures that were rigidly enforced in order to maintain the low levels of corruption within the organisation. In particular, the credit policy guide sets down, in great detail, the procedures for the loan application process, and stipulates the separation of duties. All of these policies and procedures were designed to keep corruption to a minimum, with checks and balances to reduce the length of time that an application process takes so as to discourage bribes from loan applicants to speed their application up. The credit policy guide goes as far as setting out the layout of different types of letter, contract or memo for every conceivable scenario. This has reduced the opportunities for officials to use their discretion (and to engage in corrupt practices) to very low levels. For instance, Fund A's credit policy guide specifies how the loan should be processed, starting from the Customer Service Credit Division. The guide states the following:

1.1 Customer Service – Receive Loan Application

Customer Service Team will take responsibility for receiving and reviewing the initial submission for loan application based on details described in 4A1...

1.2 Preliminary Credit Assessment:

¹³⁹ Personal communication interview 24

The Team Leader concerned will receive the completed application form and related documents from the Customer Service Division. Within three working days he will take one of the following actions:

- Write to the project sponsor requesting them to provide the necessary fundamental documents (if any)
- Register the application as a pre-screen to himself and;
 - a) Request a translation of the feasibility study into English (if necessary).
 - b) Prepare a preliminary credit assessment.
 - c) Request the preliminary assessments from the manager of the Marketing and Technical Consultants Divisions

1.3 Preliminary Marketing Assessment:

On receipt of the completed feasibility study and a request for preliminary assessment, the manager of the Marketing Consultancy Division will allocate responsibility for a preliminary review to a Team Leader.

Within 15 days the Marketing Team Leader will review the submitted documents and prepare a preliminary marketing review (PMR) including a list of any additional information required in order to enable the preparation of a full marketing appraisal. The PMR will be forwarded to the concerned Credit Team Leader.

1.4 Preliminary Technical Assessment:

Within 15 days the Technical Team Leader will review the submitted documents and prepare the preliminary technical review (PTR) including a list of any additional information required in order to enable the preparation of a full technical appraisal. When the Technical Team Leader has received sufficient information for a full technical appraisal to proceed, either from the initial document submitted or after the credit team leader has obtained these from the client and forwarded them, he will issue a memo acknowledging receipt of the necessary information and assigning a technical consultant to perform the full appraisal. This memo is then sent to the credit team leader with copies to the relevant:

- Technical consultant;
- Deputy department manager;
- Credit division manager;
- Marketing consultancy division manager;

- Coordination and credit information analysis division manager (for data entry)

1.5 Credit Team Leader Follow Up

Within two weeks the Credit Team Leader should receive preliminary reviews from the Marketing Consultancy Division and from the Technical Consulting Division indicating either:

- A list of any missing information, or
- Confirmation of the adequacy of the information for the project appraisal and assigning a consultant.

In order to expedite the pre-screen process it is the Credit Team Leader's responsibility to clarify, to the project's sponsor, the fund's pending requirements to register the loan application through a follow up meeting and correspondence, as appropriate.

Where the information is not forthcoming, the Credit Team Leader should prepare a cancellation memorandum addressed to the manager of the Coordination and Credit Information Analysis Division, with copies to the manager of the Credit Department, Deputy Manager, relevant Credit Division Manager, and Technical and Marketing Division managers.

The rigid policies and procedures laid down by Fund A's manuals were designed to limit the discretion of the officials within Fund A, specifically to reduce the opportunities for corruption. As a great deal of discretion had not been given to the officials and the levels of corruption within Fund A were considered very low, this policy could be considered successful in this regard.

In addition to this, the policy manuals specify the time limits for processing each stage of the loan application process in detail. This was designed to expedite the application process, meaning that there were fewer delays while a loan was processed. The lack of delays in this process meant that there was little point in a loan applicant attempting to bribe an official to speed his application up as the application was being handled as quickly as possible under the procedures laid down in the manuals. Therefore, this potential opportunity within Fund A appears to have been greatly reduced as the levels of corruption were so low, so this could also be considered a successful policy.

In cases where the time limits on any stage of the loan application process were breached, the manuals also set out who was responsible for managing the breach and ensuring that the application remained on track to be processed in a timely manner. These responsibilities acted as a further preventative measure against corruption, as any official attempting to slow down an application in order to receive a *speed money* payment would find himself under scrutiny from more senior officials, including his line manager and the credit team leader (who would scrutinise all overdue applications), as well as the Internal Audit Department (who would take samples of overdue applications to discover the reasons for this).¹⁴⁰

Another strength of Fund A's manuals is the provision of examples to ensure that all officials fully understood the procedures so that they could be implemented correctly. To illustrate this, there are articles in the credit policy guide regarding how to conduct a project cost verification. They provide an example of how to calculate the disallowed amount to be capitalised.

Providing examples in the policies for officials to follow, for example on the capitalisation of assets, has also reduced the opportunities for corruption. Without firm examples to follow, an official could have justified a corrupt decision by claiming that he misinterpreted the rules because they were not clear or had grey areas which were open to interpretation. This did not appear to be possible within Fund A because the policy manuals provide examples; therefore, the opportunities for corruption have been reduced.

In addition to this, the credit policy guide also determines the responsibilities of all personnel throughout the loan application process. For example, the guide lays down the responsibilities of the credit consultant as follows:

When a loan application has been assigned to a credit consultant, he becomes responsible for all aspects of the fund's relationship with the applicant. The objectives of the credit consultant at this stage are:

1. To ensure that an accurate and realistic credit appraisal is conducted on the proposed project.

¹⁴⁰ Personal communication interview 13

2. To ensure that timely and professional services are provided to the applicant during the application process.
3. To ensure,, on completion of the appraisal that a recommendation is made either “for” or “against” the project...

In order to achieve these objectives, the credit consultant will have the following responsibilities:

- Coordination: the credit consultant will coordinate with other divisions to ensure that the marketing and technical consultants conduct their appraisals in a timely fashion.
- Timing: after being assigned responsibility for the application, the credit consultant should prepare a realistic schedule for completion for the appraisal; thereafter all fund personnel should conduct their duties in accordance with the appraisal timing agreed upon.
- Site Visits: [the consultant] will visit the site periodically to observe progress on implementation. The technical consultant will probably accompany the credit consultant on at least one such visit...
- Progress Report: the credit division team will prepare brief monthly status reports on applications within their portfolios.¹⁴¹

The policy guide does not stop at laying down policies and procedures to process loan applications, but extends its scope to cover objectives and responsibilities of officials involved in the loan application process. For example, in more complicated projects, where more time was needed to carry out checks on their viability, the official responsible had to provide a realistic schedule for the completion of this stage of the process, which in turn could be monitored by his line manager who could hold the official accountable based on the timescale laid down. In addition, where loan applicants failed to provide necessary information on time, officials still had to provide progress reports stating why the delays were occurring. The guide also stipulates the necessity of officials carrying out periodic site visits to ensure that projects are progressing in accordance with the applicant’s business plan.

¹⁴¹ Fund A’s credit policy guide.

The importance of the rigidity of Fund A's policies and procedures in keeping corruption to low levels could be seen in the fact that there was a general consensus among Fund A officials interviewed that the key difference in levels of corruption between Fund A and other government agencies was the rigid enforcement of policies and procedures.¹⁴²

One senior official stated:

In most organisations, there are policies and procedures, yet the way executive management in many government agencies interpret these rules is very elastic¹⁴³.

The effectiveness of these rigid policies and procedures may have been hindered by the fact that they were not published for public scrutiny, and were not available on Fund A's website. However, loan applicants were informed about information relevant to their application, for example the expected time the loan would take to process and how each loan was generally processed.

As well as enforcing rigid policies and procedures, Fund A had mechanisms for reviewing them to ensure that they remained effective and fit for purpose. In order to achieve this, the Internal Audit Department was tasked with the analysis of policies and procedures as set out in the manuals and to suggest updates if they were no longer effective. For example, it was found that part of the loan application process stipulated that applicants' insurance policies must be checked when an application was initially made. However, no further checks were made once the application process was underway to ensure that insurance policies had been updated upon expiry. This was noted by the internal auditors who questioned why subsequent checks were not carried out. It was pointed out that the credit policy guide did not make this check compulsory and so these checks never took place¹⁴⁴. This example showed that there was a commitment in place within Fund A to update the policies and procedures to ensure they remained relevant in maintaining low levels of corruption within the fund.

¹⁴² Along with soft control mechanisms such as the intensive training programme and the meritocracy recruitment

¹⁴³ Personal communication interview 25

¹⁴⁴ Personal communication interview 16

Another example that demonstrated the commitment to rigidly enforcing policies and procedure was the insistence that all officials wore their identification badges at all times. This policy was applied to all officials, including the senior management and officials on any site visits.¹⁴⁵

The wearing of identification badges was a measure that could prevent corruption if rigidly enforced. If a staff member wanted to hint at, or request help through corruption he had to do so knowing that he was easily identifiable if he was wearing a badge. However, if identification badges had not been compulsory it would have been easier to avoid detection.

Whilst having rigid policies and procedures (which necessarily meant that a great deal of discretion was removed from officials) would reduce levels of corruption, by reducing the opportunities for officials to act corruptly or increasing the chances of them being caught, it also could have a negative effect on the aims of the organisation as a whole. For example, one joint US/Saudi project applied for a loan. The credit policy guide insisted that there was a 100 per cent guarantee on the loan split 20-80 between the US and Saudi firms who would benefit from it, however the US corporation also had a policy of not guaranteeing loans for projects planned abroad, and so the Saudi firm offered a 100 per cent guarantee. As this did not comply exactly with the credit policy guide, the loan application was rejected, even though Fund A had a 100 per cent guarantee that the loan would be repaid even if the project itself did not succeed. Perhaps, with this 100 per cent guarantee, the loan should have been approved and the project should have been allowed to continue, and the rejection of this loan may have been the result of bureaucracy for the sake of bureaucracy.¹⁴⁶ In other words, while the rigidity of policies and procedures reduced the level of corruption, it seemed to have affected the level of efficiency negatively in terms of Fund A achieving its strategic objectives.

The rigidity of Fund A's enforcement of policies and procedures existed to the extent that they were picking up on committing to the official document templates, including the font size and typeface. One official stated:

¹⁴⁵ Personal communication interview 12 and observed by the researcher

¹⁴⁶ Personal communication interview 31

You send the report you have produced for review and it comes back from senior people, it will come back with, “The heading’s in the wrong font” or, “This should be in bold” or, “This guy should be on top of that guy in the list” [laughter] and no comments about the actual content which relates to the loan.¹⁴⁷

Another official confirmed the same finding stating the following:

I know for a fact that I have given copies of things to people to review, a couple of reports I’ve written, and the feedback has come back, “This job title is an acting, not a departmental, but its acting departmental manager. And, you should put them in this order. Oh, could you tell me what this word means?” [Laughter] as in, sort of, I’d used a big word, or, “They should be capitals.” And, I’d think, “Well, does anybody actually read those things?”¹⁴⁸

One of the drawbacks of having too rigid policies and procedures was that sometimes there were so many checks on loan applications, that managers would assume that any errors would be detected by their manager (or their manager’s manager, and so on) and so could rush through checks, missing mistakes. However, as all loan applications were checked thoroughly, any manager consistently missing errors would very likely be picked up for this, which would mean they could miss a higher pay rise at the end of the year. This therefore mitigated the risk of carelessness becoming endemic throughout the organisation, as there was a clear financial incentive to check loan applications thoroughly and not rely on other officials picking up the errors.¹⁴⁹

In short, it could be concluded that Fund A implemented rigid controls over most activities within the fund. There were step-by-step manuals for every part of the loan application process and these dictated how the application must proceed. This removed a great deal of discretion from the employees, especially at the lower levels where even the format of letters was covered and set as standard. This greatly reduced the opportunities for officials to engage in corrupt practices and showed a strong link between this element and the low levels of corruption within Fund A.

¹⁴⁷ Personal communication interview 32

¹⁴⁸ Personal communication interview 31

¹⁴⁹ Personal communication interview 31

3.4.3 Information and Communication

3.4.3.1 Using relevant information¹⁵⁰

Interviews with senior officials revealed that Fund A had poor quality of information to support the function of internal control. This could be evidenced by two examples. First, although Fund A was supposed to be a not-for-profit organisation which should only charge for the cost of making a loan, it made a profit on many of its loans because the fund had no method of calculating the cost of the loans accurately. As one senior official stated:

[We have no way to] work out the effective cost of finance, taking into account the size, tenure, timing of dispersals, timing of principle payments...[this was a] useful benchmark to look at how much it costs in comparison to external sources¹⁵¹.

Second, regarding monitoring customer service satisfaction, the fund did not collect basic information on the time taken for an application to be processed from initial receipt of the application until the first funds were disbursed. This appeared to be the minimum amount of information required to measure customer satisfaction, but even this information should still be broken down to give a more accurate picture. As one senior official said:

Quality information from a time point of view would be a series of measures for the overall time taken between receipt of customer application and the first disbursement of funds. Then we'd split that down into time taken to clear pre-screen, the time taken to finalise the project evaluation report review at the loan committee and approve, and then the time taken to clear conditions, then the time taken to satisfy special conditions, and submitting cost claims for dispersals to commence, and then it would be split down even further into time taken for the marketing evaluation, the technical evaluation, the safety evaluation, etc.¹⁵²

There appeared to be very little link between corruption and quality of information, as Fund A was perceived to be the least corrupt government agency but it had poor quality of information. Fund A did not have a process in place to identify the information needed to support the function of internal control, either from internal or external

¹⁵⁰ All paragraphs and quotations on this section is based on personal communication interview 31

¹⁵¹ Personal communication interview 31

¹⁵² Personal communication interview 31

sources. This seemed to affect its efficiency, rather than its levels of corruption. As one official commented:

If I managed to get some of this information I'm asking for, I think we could start the fund on a journey which would improve the loss of our customer by having a far more efficient application approval process. I think we would improve the quality of the advice that we give clients, because I don't think that we utilise our so-called 'expertise', from a consultancy point of view, particularly well.

I think we would be more selective in terms of the industries and the types of projects that we allocate funds to, because we would be more informed as to the impact those projects were likely to have on a broader range of objectives relevant to the fund as a whole, rather than just, "It's a loan, they're going to pay it back, give them the money." We would actually be cognisant of how we thought that project would impact the Saudi economy in the long term"¹⁵³.

Theoretically, measuring customer satisfaction should help in curbing corruption. For example, if Fund A carried out detailed customer satisfaction surveys on clients who successfully applied for loans and, just as importantly, on clients who had their loan applications rejected, then they would be more likely to uncover any corrupt practices. It is important to question rejected applicants because they may have been solicited for a bribe to process their application and have refused to pay up. Without asking these questions of rejected applicants, senior management may never know that this type of practice occurs, as successful applicants who paid a bribe to push through their application would be less likely to admit it as they themselves acted corruptly.

The counter-argument to this is that Fund A was considered the least corrupt government organisation in Saudi Arabia, and the internal controls that they had had in place since its inception had been effective in keeping levels of corruption very low. Therefore, there was no need to carry out extensive client surveys into whether successful and unsuccessful applicants had been solicited for bribes by corrupt officials, because that would have left a negative impression on Fund A's employees as it would question their integrity. However, this argument can itself be countered by saying that gathering information on potentially corrupt practices acts as a brake on anyone attempting to solicit bribes from loan applicants as they would be less likely to do it if they might be caught – especially in an organisation that has a reputation for being incorruptible. It would be impossible to assess the added value of carrying out such a

¹⁵³ Personal communication interview 31

client survey unless this survey was conducted. It should not be assumed that corruption will never occur just because it has not appeared on the surface previously.

3.4.3.2 Internal communication

Fund A's emphasis on separation of powers led to a lack of communication between different departments, as illustrated by an expert who stated the following:

It's almost as if all of our teams are operating completely independently and not talking to each other when appraising a project. The appraisal will come forward with six different reports, all starting with the same but different description of the nature of the project.¹⁵⁴

Within Fund A, communication was still considered a problem, despite some improvements having been made in this area since 2012. There was no connection between the board of directors and senior management including the Internal Audit Department. The director general was the main focal point, and the board did not have any committee, so there was no flow of information from any individual within Fund A except for reports that passed through the director general. Neither senior management nor any of Fund A's officials knew or recognised the attitude or even the role of board members, despite the fact that Fund A's bylaws clarified their roles.¹⁵⁵ For example, internal auditors only saw the minutes of board meetings rather than having open channels of communication where discussions regarding the board's attitude to issues such as inefficiency or any grey areas of regulation could be discussed. Without this, it was difficult for the internal auditors to ascertain the board's expectations of them.¹⁵⁶

In Fund A, there was an intranet site where new notifications were constantly received. This included reminders and feedback in case a new law was introduced or new procedures were put in place. Yet there still appeared to be weaknesses in communications, since some circulars that were sent to the managers and employees had not been updated. For example, when the board of directors raised the authority of

¹⁵⁴ Personal communication interview 31

¹⁵⁵ Personal communication interview 12

¹⁵⁶ Personal communication interview 14

the management committee to approve a loan from USD 3.75 million to USD 8 million, the internal auditors were not notified.¹⁵⁷

The failure to communicate changes in authority levels to the Internal Audit Department adequately could also have consequences for internal auditors' ability to detect and prevent corruption. The internal auditors within Fund A were tasked with checking for non-compliance in the application process. If the levels of authority changed, but the internal auditors were unaware, then they would uncover a number of applications that they considered to be non-compliant when in fact, under the updated instructions, they were compliant. This was inefficient, and could obscure the cases that were non-compliant because they were processed corruptly behind all the cases that the Internal Audit Department believed were non-compliant because they were working to out-of-date regulations. This could increase the chance of corrupt loan applications being missed by the auditors, which in turn could encourage corrupt officials to try to process more corrupt loan applications. However, the consequences of lack of communication were minimised by the good relationship and cooperation between the Internal Audit Department and other departments as internal auditors were, in most cases, informed prior to any audit of any update in the manuals, including any change in authority level.

Also, more than one interviewee highlighted their struggle with bureaucracy and the chain of command. In Western organisations, if information or clarification is required from a senior manager they can be approached directly for the information. However, in Saudi Arabia this is not possible and is frowned upon. The request would have to be put via the official's line manager, who would refer it up to his manager, and so on until it was referred to the correct senior official. This was considered to be very time consuming and a highly inefficient method of gathering relevant information. As one official pinpointed:

I think that there is too much emphasis on formal communication. Too much emphasis on memos and emails and sign-offs, whereas you could do much better by just going up and seeing...over there and saying, "Look, I'm waiting for you to approve this thing. Is there a problem going on here?" Just get it sorted out. I don't see a lot of personal communication going on, certainly among managers. It's almost like you're not allowed to go and see the manager, the one above you. You know, like say, I don't even know who, or I never knew

¹⁵⁷ Personal communication interview 12

who the director general was or the assistant director generals. I don't know who these people are. I never see them. Even my own department manager, I know him but that's because I knew him from before, but in the first nine months I think I only saw him twice...outside Arabia, if I had a problem I would go to the CEO, sometimes just walk into his office or certainly if he's got a secretary, they don't often these days, say, "I need to see him. When is he around?" She'll say, "Three o'clock tomorrow Can you make that?" "Yes, I'm there" and I will go and talk to the CEO...because then all the people who are between you and the CEO, will then be saying, "You're a bad guy. Why did you do that? Why didn't you see me? You're supposed to see me and then I go and see him and then he goes and sees..." [Laughter] and finally it gets to him but then the message is lost by the time it gets to the CEO or the director general, and that's why...the manager is also coming down to see you all the time. He will be walking around here. In fact, he wouldn't be up there, he would be sitting here.¹⁵⁸

Another official highlighted the fact that there was no monthly meeting on an organisational, divisional, or departmental level to discuss issues that had arisen. He also went on to say that there was no "hotline" to the director general for officials to contact him and express any concerns that they may have.¹⁵⁹

In addition to this, there was a lack of communication between the IT Department and other departments, and senior management. The IT Department was blamed by the senior management for allowing the IT systems to fall behind those of other government agencies¹⁶⁰. The IT Department, on the other hand, needed to inform senior management that it was not their responsibility to facilitate communication between themselves and the individual department – a business development department or project manager was required to ascertain other department's business needs and ask IT to solve these problems¹⁶¹. This had led to a breakdown in trust between IT and senior management.

The lack of communication can be understood within the context of Fund A's establishment and culture. This culture was very focussed on the confidentiality of its information, and was very deeply rooted in the establishment of the fund by the Western bank that was instrumental in setting up Fund A at the time.¹⁶²

¹⁵⁸ Personal communication interview 32

¹⁵⁹ Personal communication interview 16

¹⁶⁰ Personal communication interview 25

¹⁶¹ Personal communication interview 24

¹⁶² Personal communication interview 22

As a result of having too much information caused by the duplication of reports in the loan appraisal process, the board tended to find it more difficult to assess each project objectively, allowing potentially corrupt applications to succeed. According to one senior official, “They can’t see the wood from the trees if there is so much free format, jumbled information”.¹⁶³ Currently, because of the lack of communication between the internal auditors and the board of directors, the internal auditors take their direction from the director general.¹⁶⁴ Common sense would suggest that this would increase corruption, as the director general would be all-powerful, with no oversight from the board, as they would not be in a position to hear about corrupt practices from within the organisation. However, within Fund A this did not appear to be the case as the director general was considered clean from corruption and, as the internal auditors work under his direction, he empowered them to work with him to keep levels of corruption low.

3.4.3.3 External communication

The general findings from many interviews suggested that Fund A’s communication with external parties was poor. For example, there seemed to be a lack of trust between Fund A and the external government auditors over the way the board increased the remuneration of its officials. The board carried out a benchmarking exercise to ascertain the market rate for officials’ salaries, so that they could try to reduce the gap between Fund A salaries and private sector salaries. The board therefore took the decision that Fund A’s bylaws allowed them to maintain the efficient running of the fund, and decided this could be done quickly without following the lengthy bureaucratic procedure that would be required to have the salary scale altered, so upon completion of the benchmarking exercise, their officials were given higher financial rewards. Fund A’s salary scale was introduced when the fund was set up, and the external government auditors suggested that this salary scale must be adhered to. However, when they carried out an audit they would discover that the board had authorised higher financial rewards to officials than was allowed under the salary scale. This was interpreted by the external government auditors as a breach of their powers and as such this decision was

¹⁶³ Personal communication interview 31

¹⁶⁴ This paragraph and subsequent paragraph is based on personal communication interview 14

questioned and a report outlining this breach was made to the Prime Minister. Fund A's board of directors, however, believed that the byelaw governing Fund A allowed them to offer their own financial incentives to officials and as such, they were perfectly within their rights to do so. This conflict created a situation of mistrust between the board of directors at Fund A and the external government auditors, and led to the relationship between the two parties deteriorating.¹⁶⁵

Fund A's decision to offer greater financial incentives to their officials was driven by the board's desire to reduce its high levels of staff turnover. The board believed that a high turnover of staff reduced the efficient and effective running of the fund and as their job was to oversee the good governance of Fund A, they decided that offering their officials greater financial incentives was the most effective way of achieving this. The Fund A board offered the higher financial incentives to their officials because the board was made up of highly competent individuals with relevant experience in the industries in which the fund operates. Therefore, the board were well aware of the higher salaries on offer in the private sector, and the issues that higher staff turnover could cause in terms of inefficient and ineffective running of the fund.

The board's decision to increase the financial rewards of their officials was intended to address the issue of high staff turnover. However, it also had the effect of increasing the cost of engaging in corruption, in particular the increased remuneration resulted in making the cost of being caught and fired as a result of being corrupt much higher. Consequently, it could be concluded that despite the lack of communication with external agencies, and despite the deteriorating relationship between the board and the external government auditors, this appeared not to have had an effect on the levels of corruption within Fund A. In fact Fund A's decision to act in this way, without going through the bureaucratic processes required to have the salary scale altered, may have had the effect of keeping corruption levels low because without these increased financial incentives, senior officials might have engaged in corrupt practices to top up their salaries, or they might have taken up higher paid positions with private sector organisations, meaning that less competent or less incorruptible officials might have been appointed in their place.

¹⁶⁵ Personal communication interview 7

As a result of their poor relationship with the external government auditors, Fund A's management appears to have been meticulous in ensuring that all departments were compliant with its policies and procedures. This was driven by the belief that the external government auditors were becoming increasingly fastidious in finding non-compliance within Fund A, either in the core business (fund disbursement) or the support functions (recruitment), which led to Fund A officials working together to reduce the levels of non-compliance throughout the fund. Being fully compliant with Fund A's policies and procedures ultimately had an effect on reducing levels of corruption, as there was an assumption that corruption was more likely to occur where there were breaches of policies and procedures.

Another example of the lack of external communication was that Fund A's official attitude towards reporting corrupt practices was that there were no clear laws to protect "whistle-blowers" who report corrupt practices to outside agencies, as noted by one official, "If I uncovered corrupt practices I wouldn't report them to the Saudi Anti-Corruption Agency because there are no clear procedures to protect me from my employer".¹⁶⁶

Summary of Hard Control Anti-corruption Strategy

The following table provides a brief assessment of the research findings based on the discussion in section 3.4, utilising the COSO framework's categorisation of risk assessment, control activities, and information and communication.

¹⁶⁶ Personal communication interview 14

Table 3.2**The effectiveness of Fund A’s hard control in tackling corruption**

| Internal control elements | Contribution to Fund A’s Agent low corruption | Contribution to Fund A’s Sub-agents low corruption |
|--|--|---|
| <i>Risk assessment</i> | | |
| Identification of objectives | Low | Low |
| Identification of risks to the achievement of objectives | Low | Low |
| Addressing corruption risks | Medium-low | Medium-High |
| Identifying and analysing significant change | Low | Low |
| <i>Control Activities</i> | | |
| Control activities to mitigate corruption risks | Medium-low | Medium-High |
| Transparency | Medium | Medium |
| Checks and balances | Medium-High | High |
| Control activities over technology | Low | Medium-low |
| Rigidity of enforcement of policies and procedures | High | High |
| <i>Information and communication</i> | | |
| Using relevant information | Low | Low |
| Internal communication | Low | Medium-low |
| External communication | Medium | Medium |
| Overall assessment of internal control | Medium | Medium |

3.5 MONITORING ANTI-CORRUPTION CONTROL STRATEGY

As per Fund A’s Internal Audit Charter and in line with article 14 of the Saudi Internal Audit Regulations, the Internal Audit Department was responsible for evaluating the effectiveness of internal control. The Charter states that, “They [the internal auditors]

have no restrictions, with full independence, to all laws, policies, guidelines, manuals, records, data, reports, assets...”

Before addressing how Fund A monitors its soft and hard control strategies and communicates any deficiencies, it should be noted that the total *annual* salaries of the 15 internal auditors who worked in Fund A were USD 767,715.¹⁶⁷

3.5.1 Conducting Ongoing and/or Separate Evaluations

This component was to ensure that once a control environment, risk assessment, control activities, and information and communication were in place, an organisation had evaluation mechanisms to ascertain that each of these components was both present and functioning. In other words, it made sure that these four components of internal control were up to date and remained fit for purpose.

3.5.1.1 Monitoring soft control

Fund A did not follow the COSO framework in terms of assessing the effectiveness of its internal control. Starting from the control environment, the fund did not assess how well its officials performed in terms of commitment to integrity and ethical values for two reasons. Firstly, as stated by one internal auditor, it was impossible to assess the tone from the top of the organisation when reports went to the director general. Secondly, measuring and assessing such values was subjective and therefore difficult to measure. As a result, it was more practical to measure compliance with policies and procedures which could be done more objectively.¹⁶⁸

This logic could also be applied to other forms of internal control. For example, the board of directors was supposed to demonstrate independence from management and exercise oversight of the systems of internal control. As the board was the oversight

¹⁶⁷ Personal communication interview 57

¹⁶⁸ Personal communication interview 12

body, there was no one within the organisation to oversee them, therefore only external government auditors could have possibly assessed their performance in this function.

Even from the perspective of external auditors it was not feasible to assess how well the management were performing with regard to their commitments to ethical values. One external auditor stated that:

We were suffering from low response levels of confirmation letters, so if we surveyed how well Fund A officials committed to ethical values, we expected to face the same issue [low response levels] with very little added value.¹⁶⁹

If there was systemic corruption within an organisation, any survey on corrupt practices would be pointless, as either the potential respondents would be friends and colleagues of corrupt officials or, just as likely, they would be corrupt themselves. The counter argument for this was that if enough officials were surveyed anonymously, the external auditors would eventually get responses from whistle blowers, which might include examples of corrupt practices that could be investigated. By not even trying, responses were unlikely to be received, and therefore the decision by the external auditor became a self-fulfilling prophecy.

However, Fund A's Internal Audit Department did monitor some elements of control environment, such as recruitment, although these audits were limited to compliance with HR policies and procedures. The internal auditors also carried out brainstorming sessions with individual departments to try to ascertain if any improvements could be made to the organisation's policies and procedures.¹⁷⁰

So although Fund A's internal auditors did not monitor or even assess most soft control anti-corruption strategies such as tone at the top and board oversight, they were empowered to review all Fund A activities. This included evaluating the quality and enforcement of HR policies and procedures, which are part of soft control strategies.

Subjecting all departments to a rigid compliance audit inevitably led to decreased levels of corruption, assuming that compliance by itself can limit corruption which was the case within Fund A. For instance, Fund A was renowned for its high quality, corruption-free recruitment system. It had very clear procedures regarding the steps to be followed

¹⁶⁹ Personal communication interview 6

¹⁷⁰ Personal communication interview 16

by the Human Resource Department when appointing an official – starting from receiving the applications, through the filtering out of applications based on objective criteria (e.g. GPA scores), the interview process and who should be on the interview committee, right up until their appointment. The Human Resource Department knew that they would be subject to an audit every two to three years, and that this would involve taking a sample of recently appointed officials and ensuring that their application had been processed correctly. In other words, if the department's personnel decided to favour an appointment by bypassing or overriding any stage of this process, they knew there was a good chance of this being uncovered by the Internal Audit Department. However, even a rigid and well-established internal audit such as the one regularly conducted on Fund A's HR procedures could have loopholes. For example, at Fund A, the audit only examined applications once they progressed past the first stage – the initial application on Fund A's website. However, no audit was made on the decisions to exclude candidates from the second stage – the interview process. Therefore, it was possible that good candidates who fit the criteria required to progress were filtered out for corrupt reasons – *i.e.* to remove potential rivals for a candidate with links to someone in the Human Resource Department who also fit the criteria necessary to do the job but was less able than some others. However, interviews with internal auditors revealed that they had not previously thought about this loophole, as their procedure was to take a newly appointed official and work backwards through his application process to check that he had been selected fairly and met the required standard at every stage of the application process. They never carried out an audit by selecting someone who had been rejected and checking through their application to see if they had been excluded for the right reasons – *i.e.* failing to meet the standard at the stage where their application was rejected. However, when questioned about this, it was clear that the internal auditors thought that the standards set by the Human Resource Department were so high that this problem was likely to be so small as to be almost non-existent and that in any case there was a level of trust in the HR Department not to attempt to carry out such a corrupt practice. They also highlighted the fact that the official who was tasked with filtering the applications once they had been posted on the website would have his work monitored by his manager who also had access to the website applications. Therefore, this acted as a control on the ability of an official to

corruptly reject an application as there would have to be some form of collusion between the official and his manager for this to happen.¹⁷¹

3.5.1.2 Monitoring hard control

In accordance with the COSO framework, Fund A reconsidered its risk management function and established a new risk management unit. Therefore, one could conclude that the monitoring of risk assessment was functioning and present as of 2014. Prior to that, Fund A had used their compliance assessment as the main way of monitoring all departments. Their risk management practices were not in line with internationally recognised best practices – including the COSO internal control framework.

When it came to monitoring control activities, Fund A focused on the rigid compliance of its policies and procedures as the most effective method of minimising the risk of corruption. The process of carrying out an internal compliance audit was explained by one internal auditor as follows:

This focus [compliance audit] centres on our department, which prepares an audit universe and an audit coverage. The audit universe had the names of all departments and gives them all risk ratings. Its records go back to 1981. The audit coverage has self-assessments and internal audit input. We review the core business on an annual basis to make sure that they are in compliance with all relevant policies and procedures.

The internal audit prepares the annual audit plan which specifies all departments that are to be audited, and the objectives of the audit. This plan is then approved by the director general. After approval, the Internal Audit Department sends an internal memo to all departments that are to be audited, which specifies the scope of their work and asks for their assistance in understanding their policies and procedures. At the same time the Internal Audit Department also assigns qualified internal auditors with relevant experience to carry out this function. Finally, after samples are taken and intensive interviews conducted, the internal audit report is issued... Fund A does not focus on corruption but its policies and procedures make nepotism in loan activities very difficult. However human nature makes this possible, but very unlikely.

The Internal Audit Department has two units, the IT audit, and the internal audit operations unit. Both of these units work together in preparing the final audit. There is no limit to the number of visits to each department, but usually HR is reviewed every two years and the core business (credit, marketing, and

¹⁷¹ Personal communication interviews 12 and 14

technical) on an annual basis. In the past five years, internal audit has reviewed all Fund A's departments, and taken a risk assessment approach, except for one department, the internal control division. This division prepares the fund's financial statements and authorises financial transactions before they occur, and is considered part of the fund's system of internal controls, which is why they have not been audited – however we thought that this division should be subjected to an internal audit also...

With regard to the abuse of public office, it can only be discovered if sampling is used and professional scepticism employed...Before doing a compliance audit the internal auditors will ask for any exceptions to examine all exempted cases...We also make sure that there are no exceptions when implementing Fund A's manuals, and if exception exists, approval from the director general must be presented. Our focus is on the active loans. We pay extra attention to loans for large sums of money.¹⁷²

With regard to monitoring information and communication, it was clear that most Fund A officials suffered from a lack of communication and information, which could mainly be attributed to the culture of confidentiality and the way the fund was set up.¹⁷³

Therefore, although risk assessment seemed to have been very helpful in eradicating corruption within Fund A, the Internal Audit Department had never assessed their risk assessment function and had not even tried to match their work with the international internal audits standards of risk-based audit. A lesson that could be drawn from Fund A's case is that a limited compliance risk assessment rather than a more comprehensive risk assessment (*e.g.* including assessments of operational, human capital, technological, legal, social responsibility and sustainability risks) is sufficient to minimise corruption.

It seems that having rigid compliance audit worked well in Fund A because they had the right control environment in place – *i.e.* officials with strong integrity credentials – because everyone within Fund A knew their expectations and knew that they would be held accountable by the internal audit and senior management.

Since information and communication did not appear to have a strong link with corruption within Fund A, monitoring such activities was not considered as important as monitoring control activities.

¹⁷² Personal communication interview 14

¹⁷³ *E.g.* personal communication interviews 14, 15, and 16

Having both the IT audit unit and the operational units working hand in hand within the Internal Audit Department put Fund A in a better position to discover any weaknesses or loopholes in its systems, which might have increased the opportunity for corruption.

By keeping records of internal audits dating back to shortly after the fund's establishment, this appeared to indicate how seriously the current and previous management of the fund treated the identification of violations and weaknesses of Fund A's policies and procedures, and how rigorously they ensured that all corrective measures were taken to promote the culture of compliance, which in turn was designed to keep corruption levels low.

3.5.2 Communicating Deficiencies

As per Fund A's internal audit charter, the Internal Audit Department was responsible for evaluating and communicating any internal control deficiencies to the director general, who was entrusted by the board of directors to take any corrective action to fix internal control deficiencies. However, the director general had to refer to the board of directors in case there was a need to modify the internal audit charter.

Since the Internal Audit Department worked under the supervision of the director general, the internal audit charter was developed to serve the interests of the director general, assuming that there was no conflicting interest between him and the board of directors as both of them wanted everyone to adhere to Fund A's policies and procedures. The Charter states:

This charter was prepared in accordance with *the unified guidelines for internal audit units within government organisations*, and with internationally recognised auditing standards...

The main objectives of the Internal Audit Department were to provide independent assurance and consultation, *to help the executive management* in performing their duties with the highest efficiency and effectiveness...

Supervising the implementation of projects based on *executive management instructions* to the extent that it does not conflict the internal audit from achieving its objectives objectively and effectively...

Initial reports with each internal audit result or special projects are prepared by the internal audit manager or his deputy. Then it should be distributed to all

relevant parties, plus *sending a summary of this initial report to the Director General*. The department under audit must respond to internal audit queries within 15 working days, with the aim to *issue the final report to this department and cc the Director General*. The final report should include the response of each audited department, and any corrective action that has been taken, with a timescale showing the expected time for carrying out any corrective action...The head of internal audit should prepare an annual report on internal audit activities within 90 days after the fiscal year has finished *and provide the Director General with this report...The Director General has the right to consult or ask experts to evaluate the work and results of the Internal Audit Department*¹⁷⁴.

Clearly there was a misunderstanding of the Unified Internal Audit Guideline¹⁷⁵ which states that the internal audit unit should report directly to the highest authority within the government organisation. From a Fund A perspective, they considered the director general as the highest authority. Yet in reality and in accordance with the fund's byelaw and the government external auditors' understanding, the board of directors was the fund's highest authority¹⁷⁶. Although it was suggested by an external consultant a few years ago that the Internal Audit Department should have greater independence and report to the board of directors via the internal audit committee, the board did not take this advice as they seemed to be satisfied with Fund A's executive management in terms of performance and good reputation. Interviews with internal auditors revealed that the executive management appreciated their work and that they would take their findings seriously because there was a mutual understanding that the Internal Audit Department added value to the organisation and would work with the departments to correct any errors at an early stage¹⁷⁷.

As discussed previously, having all internal control deficiencies solely reported to the director general empowered the internal auditor to scrutinise all activities and have unlimited access to all documents within the fund. This ultimately reduced the level of information asymmetry that existed between the director general and all Fund A's officials, leading to maintaining a low level of corruption within Fund A.

However, the board seemed to have less information on the quality and enforcement of internal control as the Internal Audit Department reported mainly to the director

¹⁷⁴ The researcher italicized the text

¹⁷⁵ This guideline is issued by the Saudi government and is applicable to all government institutions.

¹⁷⁶ Personal communication interview 7

¹⁷⁷ Personal communication interview 16

general, leading to a higher level of information asymmetry between the board and the director general.¹⁷⁸

Summary of Monitoring Anti-Corruption Control Strategy:

The research findings on monitoring controls are summarised in the following table based on the discussion in the above section.

Table 3.3

The effectiveness of Fund A's monitoring control in tackling corruption

| Internal control elements | Contribution to Fund A's Agent low corruption | Contribution to Fund A's Sub-agents low corruption |
|---|--|---|
| <i>Conducting ongoing and/or separate evaluations</i> | | |
| Monitoring soft control | Low | Medium |
| Monitoring hard control | Medium | High |
| <i>Communicating deficiencies</i> | | |
| Communicating soft control deficiencies | Low | Medium-low |
| Communicating hard deficiencies | Medium-low | High |
| Overall assessment of internal control | Medium | High |

¹⁷⁸ It should be noted that the board still received government external audit reports, yet this made little difference as these reports were not specifically designed to address internal control deficiencies and all government agencies, even with systemic corruption, went through same audits.

3.6 CONCLUSION

In conclusion, and to answer the main research question (i.e. to what extent is internal audit effective in tackling corruption), one would assume that having an effective internal control strategy based on the COSO Internal Control Framework would be vital for an organisation seeking to reduce levels of corruption and to maintain the amount of corruption at low levels. However, as discussed throughout this chapter, the effectiveness of some internal controls were clearer and therefore more important than others, and some (*e.g.* a written code of ethics) appeared not to have any noticeable effect on corruption, within Fund A at least.

However, it is clear that certain areas did have a noticeable effect on corruption. For instance, the setting of the tone at the top by the board of directors was of great importance in limiting the corruption of the director general, who in turn set his own tone at the top, which was as important in limiting the corruption of the officials working beneath him in the fund. The same could be said when it came to attracting, training, and retaining competent officials to the fund, who kept the fund's manuals updated and relevant, and ensured the rigid enforcement of them.

This chapter has also demonstrated that some elements of internal control significantly reduce the level of corruption of the sub-agents, but not the agent. This could be seen in the existing reporting lines, whereby the Internal Audit Department report their findings to the board through the director general. Thus they only consider violations that are not approved by the agent.

It is clear, however, that the three areas of internal control (soft controls, hard controls, and monitoring strategies) are inter-related and therefore need to be implemented together if corruption is to be tackled within an organisation. For instance, a director general with strong credentials could set the right tone at the top (soft control), but without clear policies and procedures that limit the discretion of the sub-agents (hard control), it is unlikely that the levels of corruption will be reduced significantly. In addition, even with both these soft and hard controls in place, it is unlikely that corruption will be tackled without rigidly enforcing the soft and hard controls (monitoring activities).

What is also clear is that the causal arrow between effective internal control and low levels of corruption appear to point in the opposite direction as well– i.e. having low levels of corruption leads to the adoption of effective internal control, as in the case of Fund A, where levels of corruption were low, the board as well as the management seemed eager to enhance or strengthen the internal control practices. This was evidenced by consistently contracting one of the Big Four accountancy firms to be the fund's external auditor, which meant that any weaknesses in Fund A's internal controls that threatened the faithful representation of Fund A's financial statements would be red-flagged to the board so that action could be taken to remedy these weaknesses. Further evidence of this was that Fund A contracted an internationally renowned consultancy firm to assess the strategic direction of the fund, which resulted in a major enhancement of Fund A's internal control with the establishment of a risk management function.

Chapter 4

The Second Case Study: Fund B

4.1 INTRODUCTION

Employing the same three strategies outlined previously (see section 3.1), this chapter examines the effectiveness of Fund B's soft, hard, and monitoring internal control anti-corruption strategies in an attempt to find out why it is rated as a medium-level corruption agency and whether the effectiveness of its internal control could provide a good explanation for this.

Under soft control strategy, Fund B's board of directors appears to have been unsuccessful (in comparison with Fund A) in establishing the right institutional integrity to prevent its agent and its sub-agents from abusing their power in their own self-interest. This could mainly be attributed to the origin of the fund as well as to the conflicts of interest presented from having a number of board members who, following their appointment to the board, were not only allowed to retain ownership and/or control of their private sector enterprises, but could continue to have their companies apply to Fund B for loans, the feasibility of which they were duty bound to oversee objectively.

The chapter concludes with a discussion of the causality between Fund B's weak internal control and its current levels of corruption. It illustrates that, whilst loopholes in internal control practices may have facilitated corruption practices, especially by low level bureaucrats, senior officials may have intentionally weakened the system of internal control to enable them to abuse their positions without being caught.

4.2 SOFT CONTROL ANTI-CORRUPTION STRATEGY

4.2.1 Setting the Tone at the Top

Fund B was established by experts from a developing country rated as highly corrupt, according to the World Governance Indicators (WGI) and Transparency International's (TI) indices. As a result of this, the institutional integrity and the tone at the top appeared to have been set by individually hired consultants, as opposed to an entire consultancy

firm, some of whom have been accused of enriching themselves and favouring businessmen over and above the public interest.¹⁷⁹

However, some respondents argued that the continuing root cause of the problems involved in establishing more effective institutional integrity at the fund lay with a number of members of the board of directors, including the chairman, having been appointed from the private sector still maintaining their previous links with companies which they own and/or still operate. This created a conflict of interest, both due to the fact that board members' companies often benefitted from loans from the fund - both before and after their appointment to the board - and because the huge sums of money available allowed board members to manipulate entire Saudi markets in favour of their own private interests. What is arguably most important here is not whether the board were actually engaged in corrupt practices, but that the perception that they were corrupt led officials within the fund to tolerate, or even engage in, corruption. For example, prior to a change in policy made in 2010, loan applicants could receive the first instalment of their loan before the project actually started. This loophole meant that applicants could use this initial payment for different investment projects with potentially higher returns but in a different industry to the one that the Fund was established to support, such as investing in the Saudi stock market. One senior official accused the chairman of the board of exploiting this loophole in Fund B's internal control. He claimed that:

The chairman requested a loan ... to finance a 200 million riyal [USD 53.3 million] project, and although he received 20 per cent of the loan as the first instalment, he did not launch the project for five years. Thus, he knew how to benefit from Fund B's loan process in accordance with the law.¹⁸⁰

Although this conduct by the chairman of the board was not illegal, it is the perception of it that could be seen to be important. If the chairman could borrow huge sums of money and not invest in a project for five years, it could be seen that he was exploiting a loophole to enrich himself and his company. This could have led to other officials deciding to exploit this or other loopholes to enrich themselves, thereby encouraging toleration by senior management. One example that helps to illustrate this is that when the fund Collection Department failed to take legal action against the director general's

¹⁷⁹ Personal communication with interviewee 51

¹⁸⁰ Personal communication with interviewee 42

brother who received a USD 533,300 loan from the fund, despite having the loan for a lengthy period of time, he never repaid it. One official stated that:

In the past, no one dared to do such a thing [asking the director general's brother to pay back his loan] even though there were no instructions from the director general in this regard... yet now, after the recent replacement of the chairman, followed by the replacement of the director general, the Collection Department is more likely to ask him [the director general's brother] to pay back his loan or legal action will be taken against him.¹⁸¹

When it came to the core business of loan applications and collections, corruption seemed to be systematic in a few of Fund B's branches. This corruption led the executive management to suspend the authority of these branches. Therefore, all loan applications, even if they were below USD 133,000, had to be referred to head office for approval¹⁸². As explained later, corruption cases in these branches were discovered by external rather than internal sources, mainly via complaints from borrowers or investigation by external authorities.

This low level of institutional integrity still appeared to be the case when the current research was being conducted. Whilst the director general was regarded as having a high level of integrity by many of his officials¹⁸³, it would appear that some corruption was tolerated within the fund.¹⁸⁴ For example, systemic corruption at the highest levels was perceived to be well established in recruitment, to the point that many officials who worked within the fund believed that it was impossible to obtain promotion or appointment to the most senior levels of the organisation without family or tribal links to a member of the senior management or board of directors.¹⁸⁵

This corruption in the recruitment process also brings into question the integrity of some members of the board of directors as it seems that the director general tolerated the corrupt appointment of family members by some members of the board because they held the power to renew (or not renew) the director general's contract.¹⁸⁶ However, this

¹⁸¹ Personal communication with interviewee 33

¹⁸² Personal communication with interviewee 45

¹⁸³ Personal communication with interviewee 44

¹⁸⁴ From the loan applicants' perspective, personal communication with interviewees 9, 10 and 30 revealed that corruption was not considered a major issue within Fund B (possibly because the applicants had no direct dealing with the director general and senior managers). Instead, loan applicants complained about the slow process of their applications and the lack of clarity on rules governing the loan application process.

¹⁸⁵ Personal communication with interviewees 31, 37, 42, 43, 44, and 51

¹⁸⁶ Personal communication with interviewee 37

is no excuse for someone in such a position of authority, as the said individual was not only the director general but also the vice-chairman of the board.

As well as the questionable integrity of the board, many senior managers abused their positions, in many cases in more egregious ways than some of the board members. For example, the director general only appointed one family member, his nephew.¹⁸⁷ However, arguably as a direct result of his appointment being due to nepotism rather than on merit, his nephew and other senior managers went on to appoint several family members of their own in a manner far worse than that of the director general.¹⁸⁸

Having established that the level of perceived corruption emanated from the board, it inevitably cascaded down to the director general, and then by extension, to the fund's remaining officials. Thus, corrupt practices in recruitment activities and some of Fund B's branches became established as acceptable operational conduct by a number of sub-agents, leading corrupt officials to justify their own practices as being condoned, or even practiced, by the board and the director general. Therefore, it could be concluded that the tone at the top set by the board and the director general in Fund B is a key factor in the higher levels of corruption throughout the fund.

4.2.2 Establishing Standards of Conduct

Based on what was observed in Fund B's general attitude towards existing, out-dated policy and procedure manuals,¹⁸⁹ the presence of a code of ethics would have no effect on the levels of corruption within Fund B. However, it was suggested by an official that a code of ethics is needed to address conflicts of interest, because the fund's policies currently allow employees to apply for loans for themselves. This presents a potential conflict of interest which could be exacerbated by the fact that some of the fund's branches are located in rural areas, where local residents often have tribal links to the staff, and it is those staff who are employed to process and monitor the loan application process.¹⁹⁰

¹⁸⁷ Personal communication with interviewee 33

¹⁸⁸ Personal communication with interviewee 37

¹⁸⁹ E.g. personal communication with interviewee 35 and 39

¹⁹⁰ Personal communication with interviewee 36

Another area where a code of ethics would prove useful would be in establishing a gift policy. At present, Fund B does not have a documented procedure for dealing with gifts. This can be demonstrated by an example from one of Fund B's branches, where some televisions were given to one of the fund's regional offices by a local business. With no gift policy to explain how to deal with this, an official recorded these televisions as being in the custody of the branch. This only came to light during an audit of the branch's fixed assets¹⁹¹. Whereas in this example there does not appear to have been an attempt at committing an act of corruption (there is no suggestion that this gift was a bribe, and the fact that the gift was recorded by an official suggests that he was trying to act ethically), without a policy to dictate how gifts should be dealt with, it seems reasonable to assume that the giving of gifts was widespread in regional branches where corrupt officials could solicit for gifts (or bribes) and were not compelled to record them. Had there been a code of ethics, the officials in this example would have known how to deal with the situation appropriately to avoid accusations of bribery.

Other problems arise because there are many grey areas that officials do not know how to deal with, as there is a lack of official guidance. In particular, with loan applications from highly influential individuals, close friends, or family members, there are no clear, documented guidelines on how to handle them.¹⁹² This situation is clearly problematic and provides the potential for corruption as there is no policy to prevent the clear conflict of interest between family members having their loans processed by family members of their colleagues.

However, given that fund employees did not implement policies and procedures in the first place, it follows that a code of ethics, especially one that implied that any breaches would not be punished, was even less likely to be respected than other policies and procedure manuals. This is evident in the endemic corruption in the recruitment procedure. The recruitment policy states that all appointments must be made on merit, yet most staff recruited after 2010 (when Fund B was handed control of all its recruitment) were appointed as a result of influence from a senior manager rather than on merit.¹⁹³ Therefore, it could be concluded that if officials chose to ignore a clear policy instruction - that staff were to be appointed on merit - they would be just as

¹⁹¹ Personal communication with interviewee 46

¹⁹² Personal communication with interviewee 39

¹⁹³ Personal communication with interviewees 33, 37, and 42

likely, if not more so, to ignore a code of ethics that documented expected behaviour but did not proscribe unacceptable practices.

Thus, it can be seen that the establishment of a code of ethics in Fund B would be unlikely to play a significant role in reducing the levels of corruption without updating and rigidly enforcing existing policies and procedures that govern specific practices where corruption might occur. For example, a specific gift policy could be written to govern how to act in situations such as the above example of a branch having been given some television sets by a local business. This would set out the level of gifts deemed acceptable and how their receipt should be recorded. It would also set out the likely punishment for failing to adhere to the policy. Establishing and enforcing such a policy would be likely to have a far greater effect on corrupt practices than merely establishing a code of ethics.

Even more importantly, the establishment of systems of checks and balances appears to be more relevant in reducing the level of corruption. Having procedures in place to prevent conflicts of interest occurring (for example, preventing loan applications from being processed by officials who are related to the applicant) and introducing separation of powers into the procedure (such as oversight by an official from head office) would have a far greater effect on reducing the levels of corruption than articulating the expectation of ethical behaviour in a document that most officials might never even read. Therefore, whilst a code of ethics might be a welcome addition to the soft internal anti-corruption controls used by Fund B, without strengthening other areas of control, such as monitoring expected behaviour and rigid enforcement of the policies and procedures already in place, it could be seen as merely paying lip service to the idea of reducing corruption, rather than a serious attempt to eradicate the problem.

4.2.3 Establishing Oversight Responsibilities

One of the key responsibilities of the board of directors in establishing its oversight function was the appointment of external accounting auditors. Fund B has invariably appointed a local accountancy firm to conduct the annual audit, justifying this decision on the grounds that the local firm charges lower fees than internationally renowned accountancy firms such as the “Big Four”, and that the public procurement contract that

governs this appointment stipulates that they must accept the lowest price tender.¹⁹⁴ However, the board had the leeway to set a minimum standard in terms of experience and reputation, and could therefore accept tenders only from internationally recognised firms, thus eliminating smaller local firms from the tender process altogether. The perceived issue with appointing a local firm is that the fees received from Fund B would make up a relatively large proportion of their annual revenue, and so they could become conflicted as they would be so keen to retain the business the following year that they could be pressurised into ignoring dubious accountancy practices.¹⁹⁵ The Big Four accountancy firms however would be less susceptible to such influence as not only would the fees make up a far smaller percentage of their total revenue, they would also have the reputation, and internal control quality assurance, of their firm to consider when carrying out any audit.

In addition to this, local accounting firms are only obliged to adhere to Saudi auditing standards, whereas international firms have more rigid international standards to adhere to. These standards include closer scrutiny of internal controls¹⁹⁶. Therefore, by appointing a local audit firm, Fund B is both accepting a lower standard of audit than might otherwise be the case, and is potentially introducing a conflict of interest in the auditors who have to balance providing a true picture of the organisation's financial strength with scrutinising too closely and losing a key client and subsequently losing a large proportion of their revenue.

4.2.4 Applying Relevant Experience

Fund B's board contained relevant experience due to the fact that some board members were appointed from private sector firms with direct involvement in the economic sector in which Fund B operates. This could be evidenced by seven initiatives that were implemented by board members using their commercial expertise to target projects that employed the Fund's capital more efficiently, leading to the financing of projects that enhanced the Saudi economy.¹⁹⁷ Whilst the application of relevant experience has

¹⁹⁴ Personal communication with interviewee 4

¹⁹⁵ Personal communication with interviewee 8

¹⁹⁶ Personal communication with interviewee 6

¹⁹⁷ Personal communication with interviewee 45 and the fund's website

enhanced the effectiveness of the fund and helped it to achieve its vision and mission to expand Saudi industry, it could also be suggested that, in terms of corruption at least, these appointments introduced a conflict between the board's oversight function and its independence which is discussed in greater detail in the next section.

4.2.5 Board Independence

The independence of Fund B's board of directors could be considered questionable in regard to its independence of the funding and lending decisions of the fund. The chair of the board is a businessperson who also chairs one of the largest borrowers from the fund¹⁹⁸. This places a large question mark over how the executive management could possibly impartially scrutinise any loan applications from this company. This independence (or lack of it) could have been further undermined by the actions of the chairman of the board soon after he was appointed.

Prior to the appointment of the existing chairman, the maximum amount that could be borrowed from Fund B was USD 5.3 million, however soon after he was appointed this limit was raised to USD 50.3 million. Whereas there might have been sound, legitimate reasons for raising this maximum limit, the decision could be seen to have been taken for the purposes of self-enrichment rather than for the benefit of the Saudi economy as a whole, as the chairman's own company was one of the first beneficiaries of the increase in this limit.¹⁹⁹ Furthermore, the decision to increase the maximum loan limit was not published on Fund B's website, nor in any of its written manuals²⁰⁰. In other words, only loan applicants who had a contact within Fund B, or at least had a verbal discussion with Fund B's officials, seemed to be aware of this increase in the loan limit.

However, one senior respondent claimed that the only preferential treatment given to board members' applications is that they are processed more quickly (which contradicts the opinions of some other interviewees). He said:

¹⁹⁸ Personal communication with interviewee 51

¹⁹⁹ Personal communication with interviewee 42

²⁰⁰ Personal observation

It goes without saying that you have to handle the chairman of the board's application promptly, yet in accordance with Fund B's loan guidelines.²⁰¹

It is interesting to note that board independence is not a new issue. One former board member of the fund stated that:

Fund B has struggled since its establishment. Thirty years ago, I was a board member... The chairman of Fund B resigned when a conflict of interest issue was raised and discussed at board level. The case involved the chairman of the board who was running one of the largest borrowers of Fund B.²⁰²

The ability to oversee the day-to-day management of the fund by the board is also questionable. In Fund B, the director general is the vice chairman and the second most influential man on the board. This puts him in the position of having to oversee his own decisions, some of which may be on applications from the firms owned and/or controlled by his fellow board members. This dual role has clear implications as to how independent the board can be from its most senior manager, as overseeing your own decisions objectively is close to impossible, and that the rest of the board's ability to act independently as a counter-balance to the director general's presence on the board is compromised by their interest in borrowing money from the fund.²⁰³

The key issue with board independence in general is that perception can be seen to be as important as reality. The perception that the chairman of the board raised the maximum loan limit for the sole purpose of benefitting his own company, as it was one of the main beneficiaries of this change, calls into question his independence²⁰⁴. Therefore, this decision appears to have undermined any positive perception of the tone at the top that was so important in creating and maintaining an institution that had low levels of corruption.

4.2.6 Providing Oversight of Internal Control

The board had restricted ability to oversee the design and implementation of the system of internal control within Fund B because of the limited tools available to them to monitor the performance of management in terms of their compliance with the board's

²⁰¹ Personal communication with interviewee 39

²⁰² Personal communication with interviewee 53

²⁰³ Personal communication with interviewee 37

²⁰⁴ Personal communication with interviewee 42

directions and approved manuals, because all communication channels were limited to merely being sent through the director general, who had full discretion in deciding which information should be provided to the board and when.²⁰⁵ This is because the board has not insisted on greater scrutiny and monitoring of the fund's systems of internal control. Even with the establishment of the audit committee, all internal audit reports had to be approved – and sometimes modified - by the director general, before he shared them with the audit committee, of which he was also a member²⁰⁶. Based on this process, if the director general were to violate the manuals or to modify any internal audit recommendations to close loopholes and address any weaknesses in the manuals, he could get away with it as long as it was not discovered by the external government auditor, as he would clearly neither report himself to the board, nor allow the internal auditors to report any serious violation or weakness in the loan process.

In the worst case scenario, if the external auditor spotted any violations of the fund's manuals, the director general could mitigate the consequences as he was also the vice chairman of the board, and many board members - including the chairman - had a personal interest in the fund and would therefore not risk losing these good relationships with the director general²⁰⁷. Therefore, a limited number of violations would be tolerated as long as they were not publicised. Indeed, this was the case as the Saudi government's external auditors did not publish nor report to the public any particular violations. If they had done so, it would have been expected that more violation cases would have surfaced as a result of whistle-blowers from inside and outside the fund. This would definitely have increased public anger, as many loan applicants and job seekers were rejected for not fulfilling the criteria of the fund, or were not given the same opportunities as more well-connected people.

Therefore, the conclusion to be drawn here is that the board failed to provide the means to monitor the performance of the fund's internal control mechanisms. They had a situation whereby the director general could control the information that the board had access to, which could allow him to engage in, or ignore, corrupt practices within the fund, whilst simultaneously keeping the board in the dark as to what was happening. Even the establishment of an audit committee could not have eliminated this lack of

²⁰⁵ Personal communication with interviewee 46

²⁰⁶ Personal communication with interviewee 33

²⁰⁷ Personal communication with interviewee 42

oversight, as the director general sat on the audit committee and still controlled what information they reported to the board. Here again the perception is as important as the reality, in that there is no clear evidence that the director general had acted improperly, but that the lack of oversight over the fund's internal controls could allow him to act improperly whilst hiding such behaviour from the board.

4.2.7 Establishing Structure, Authority, and Responsibility

In 2010, Fund B was granted independence from the Saudi civil service. As a result of this, an external local consultant was hired to update the fund's hierarchical structure. This resulted in the introduction of new departments, the merger of some departments, and the complete abolition of others. Under the new structure, every department was assigned clear objectives and responsibilities. However, based on interviews conducted with Fund B's officials²⁰⁸ it is clear that the development of the organisational structure did not involve, nor even take into consideration the views of, the vast majority of Fund B's officials, leading to a number of consequences.

First, most officials seemed to be unaware of the role of each department, sometimes even their own. This was evident in two instances: one in which the researcher was referred to interview someone in a department which did not exist (I found out later that this department had been abolished and its officials had been transferred to another department);²⁰⁹ the other in which some officials attempted to explain the loan process in Fund B, but it became clear that they were not very familiar with the names of each department under the new organisational structure, even though this structure had been introduced in 2010.²¹⁰

Second, officials were not encouraged to adopt and act upon the new organisational structure. This may have triggered managerial and administrative problems, but it was unclear if it also contributed to increasing or decreasing the levels of corruption as with the new government structure, clear objectives and responsibilities were laid down, which facilitated and simplified procedures in which every official could be held

²⁰⁸ Personal communication with interviewees 36, 38, 49, and 51

²⁰⁹ Personal communication with interviewee 36

²¹⁰ Personal communication with interviewee 38

accountable.²¹¹ However, the counter argument to this is that if the officials were not fully aware of this structure because they were not engaged in its development, or at least given training on their new roles, it was less likely that this structure would have provided any benefit to the fund, at least in the short run.

It should be noted that the external local consultant who had been hired was well-known for developing many governments' organisational structures. Comparing some of these government structures demonstrated that he had a template for a government structure, which he modified to fit the purpose of each organisation.

After drafting the new organisational structure, the consultant developed a job description manual based on the needs of Fund B's executive management. Unlike the job description he had developed in other government agencies, Fund B's manual seemed to be very flexible. The minimum requirements for most jobs stated that applicants needed an "academic degree that fits the job specification."²¹² Such statements increased the discretion of Fund B's executive management because they were not limited to certain academic degrees. For instance, in 2014 Fund B recruited a fresh graduate student even though he had a bachelor degree that was totally unrelated to the job to which he was assigned; however, his appointment was justified on the basis that he had a masters' degree that fitted well with the job's requirements²¹³. His appointment raised some concerns because many applicants who had both bachelor and masters' degrees in the desired fields were ignored.

Another problem with Fund B's organisational structure was weak enforcement. For instance, it is stated in the organisational structure manual, as well as in the internal audit charter, that the director of the Internal Audit Department should be administratively linked to the chairman of the board, and technically linked to the audit committee - yet in reality this was never implemented; all reports had to be read and unofficially modified and approved by the director general. So it could be concluded that Fund B had problems with its ability to enforce reporting lines as written in the fund's manuals.²¹⁴

²¹¹ Personal communication with interviewee 40

²¹² Fund B's job description manual

²¹³ Personal communication with interviewee 49

²¹⁴ Personal communication with interviewee 33

Further evidence of weak enforcement of the organisational structure was that the director general had not activated the loan committee that was linked to the board. Also, he has kept the position of deputy director vacant since his appointment as director general almost eight years ago, a position he worked in for twenty years prior to his appointment as director general.²¹⁵

4.2.8 Commitment to Competence

4.2.8.1 Establishing policies and procedures

Before 2010, corruption in HR activities within Fund B was very limited because recruitment was handled by the Ministry of Civil Service. The Ministry published all its recruitment procedures on its official website, including its criteria for selecting public officials. These criteria gave weightings for applicants' grade point average (40 per cent), Ministry exam results (40 per cent), and their date of graduation (20 per cent)²¹⁶. All phases of the recruitment process, starting from the application through to nomination and onwards towards selection, were processed electronically²¹⁷. The Ministry of Civil Service's role was basically limited to matching and verifying the original documents for each applicant with his or her data entry into the Ministry's online system. Also, the Ministry coordinated with some academic institutions, such as the Institute of Public Administration, to prepare and mark the exam²¹⁸.

However, after 2010, Fund B became independent from the Ministry of Civil Service and was granted the full authority of self-recruitment with a higher salary scale. An external consultant was contracted to develop the first draft of all Fund B's human resource manuals. Then the fund's executive management reviewed and modified those manuals to best serve their own needs before the board of directors approved them²¹⁹.

²¹⁵ Personal communication with interviewee 33

²¹⁶ The Saudi Ministry of Civil Service gave weight to the date of graduation because there were hundreds of thousands who sought public posts, but were still on the waiting list. On this basis, the Ministry gave preferential treatment to the applicants at the top of the list (i.e. those who had graduated earlier).

²¹⁷ This may highlight the importance of E-government.

²¹⁸ Personal communication with interviewee 43

²¹⁹ Personal communication with interviewee 49

Instead of taking advantage of self-recruitment to attract competent personnel, Fund B's employment system became very corrupt, to the extent that two officials described it as "systemic corruption".²²⁰ This was despite the fact that the fund's HR manual clearly stated that employment and promotion decisions should be solely based on merit. Favouritism and nepotism were common practices in fulfilling Fund B's vacant positions and promotion to senior positions. One official highlighted that:

Almost 90 per cent of newly recruited employees know someone in the senior management. To verify this, all that you need to do is to check the surnames of all new hires and you will find the vast majority of them match the surnames of some senior managers.... personally, I know six of my friends with very high GPAs, 4.25 out of 5 or higher, who applied for a vacant position. However, all of them were rejected in favour of one person who had a lower GPA but had good connections in Fund B"²²¹

Another senior official stated that:

Seventy per cent of entry level jobs are fulfilled based on favouritism... promotion up to senior positions is fair, transparent, and unbiased; yet in order to be promoted to managerial or senior positions you have to be well connected to a board member, or the director general.²²²

The root cause of corruption in recruitment could be linked to the following article in Fund B's guideline:

1. The fund should announce all its vacancies, and competition should be made to select the best candidate.
2. As an exception from this, the director general has the right to directly appoint any employees without competition if they have the required qualifications for these vacancies, or they have the experience that is needed by the fund, or for low status jobs [such as gatekeeper and janitor]²²³.

So, based on this article, the director general could appoint any person without being accountable because it was within his authority to appoint his relatives, for instance, without violating the law. The director general seemed to have had this authority from the board because he was the vice chairman of the board and many board members, including the chairman, had shared interests with him.

²²⁰ Personal communication with interviewees 37 and 42

²²¹ Personal communication with interviewee 37. It should be noted that this interviewee might be a little bitter, but his statement is somewhat consistent with many interviews.

²²² Personal communication with interviewee 42

²²³ Fund's B guideline

Without having clear, transparent, and rigid procedures for selecting the most competent candidates, corrupt practices were likely to flourish. Using his authority, the director general employed and empowered one official to be his assistant and a second man to be in charge of recruitment. Some officials questioned the integrity of his assistant as he had had ethical and financial issues in his previous position in another government organisation.²²⁴

As will be discussed in the section regarding attracting, developing, and maintaining officials, the Fund's recruitment policies, as implemented since 2010, have arguably been instrumental in maintaining its relatively high levels of corruption. With so many officials appointed since 2010 having been selected based on influence rather than on merit, a large number of them entered into service knowing that they achieved their appointment due to corruption – the consequence of this being that they would start with the impression that corruption was tolerated in the fund, leading to a higher level of corruption than would have been the case if they had been appointed on merit. This is a direct result of the failure to implement a more rigid, less flexible, recruitment policy at the outset in 2010.

4.2.8.2 Evaluating competence and addressing shortcomings

The main objective of evaluating competence, as per the COSO Internal Control Framework, was to ensure that every individual within the organisation was competent enough to not only understand all the relevant policies and procedures, but also to act upon them. While it appeared that Fund B did carry out such an evaluation of its officials on an annual basis, the reality suggested that such an evaluation was not objective, as many officials in some of the fund's branches have not processed any loan applications for the past five years, but still received a good evaluation.²²⁵

It is possible that such practices may have increased the level of corruption within Fund B, as some officials may have rationalised engaging in corrupt practices in exchange for their hard work. In other words, these corrupt officials would have been paid the

²²⁴ Personal communication with interviewee 33

²²⁵ Personal communication with interviewees 36 and 50

same as those officials who were doing nothing to earn their salary, and therefore accepted bribes as a reward for doing their job.

4.2.8.3 Attracting, developing, and retaining officials

As recruitment was handled by the Ministry of Civil Service from the establishment of the fund until 2010, corruption in Fund B's recruitment activities was very limited. Obviously, having a recruitment process administered electronically by an external party limited Fund B's public officials' discretion because they had no control over who was appointed²²⁶. It could therefore be concluded that this is a prime example of the consequences of allowing government institutions the discretion to appoint its own officials without establishing mechanisms to monitor the enforcement of policies and procedures in such a vital area. Fund B's officials were given this discretion and appeared to abuse it from the start, appointing officials based on nepotism and influence rather than on merit, despite having a recruitment policy that specifically prohibited this. This led to a situation whereby new officials would start work at the organisation with the knowledge that they had been appointed in a corrupt manner, seemingly approved by those at the top of the organisation. This might have led to a situation whereby officials could assume that other policies and procedures were just as flexible and open to abuse, which was likely to lead to an increase in corrupt practices. Also, the existence of corruption in recruitment might have led to several further consequences. For example, Fund B might not have appointed competent officials who were able to carry out their duties properly in both the core business and the support functions, which meant that, in the core business, incompetent officials might have approved loans that should not have been approved. This could have increased tolerance to corruption, with many projects being financed when they should not have been approved in the first place. Thus, by having a large number of non-compliant cases it would have been hard to distinguish which of these applications had been approved based on corrupt relationships (such as nepotism), and which had been approved because the officials were not competent enough to scrutinise them properly in

²²⁶ It is out of the scope of this research to discuss the consequences of limiting government institutions authority in recruiting their staff on efficiency and selecting the most suitable candidates who fit well to the organisation's needs. The main point here is that the more discretion given to government institutions the more likely corruption will flourish.

accordance with all the relevant policies and procedures. It should be noted that almost USD 1.1 billion worth of loans were never paid back to the fund, many of which should not have been approved in the first place, and would not have been if corruption within Fund B was lower.²²⁷

What appears to have been the most harmful impact of this potentially corrupt recruitment system occurred when some internal auditors were appointed based on connections rather than on merit. As might have been expected in the case of Fund B, it was highly unlikely that these internal auditors would expose any corrupt practices committed by those who gave them preferential treatment by appointing them in the first place, whilst neglecting those who were more qualified.²²⁸

The existence of corruption in recruitment may have led to the hiring of less qualified professionals in the Internal Audit Department. Having incompetent or less competent internal auditors would have hindered the effectiveness of the department, as less competent internal auditors would not have been equipped with the necessary skills and knowledge to discover corrupt practices. Plus, even if they did discover corruption, they were unlikely to risk their jobs by exposing it and challenging the senior management.

It should be noted that having corrupt recruitment did not mean that anyone with connections who applied for a position in Fund B was immediately accepted. Usually, candidates needed to have a GPA of 2.75 out of 5 or higher. One senior manager who did not claim that Fund B had a highly corrupt recruitment system, said:

I talked to the interview committee about accepting one of my relatives, yet they said ‘no, sorry’ because his GPA was below 2.70²²⁹

Whilst this interviewee suggested that this example confirmed his assertion that the recruitment process was not corrupt, if this employee really thought that the Human Resources Department was incorruptible, he would not have approached them in the first place, which helps support the finding of this research that potential applicants should have some sort of connection to be admitted into the fund.

²²⁷ Personal communication with interviewee 33

²²⁸ Personal communication with interviewee 37

²²⁹ Personal communication with interviewee 36

One lesson that could be learnt from this is that corruption could lead to weak internal control. In Fund B, the executive management proposed very flexible HR manuals, which basically gave the director general the authority to appoint any employee without being accountable to any standards. Also, the board empowered the director general to supervise and monitor the Internal Audit Department, which itself was not empowered, or at least was never asked, to review either the recruitment activities or the HR manual, nor did it draw the board's attention to these internal control weaknesses. In other words, corrupt officials might weaken internal control practices so they can get away with their own corruption.

Since many officials were appointed based on connections, these officials were less interested in training because they found the cost of undergoing training exceeded its benefits²³⁰. In the context of the fund, the benefits of training were merely to improve officials' competency. However, such benefits were decreased because Fund B's officials would only have been expected to improve their competency if they were going to obtain any benefit from this, either inside the fund or in the labour market.²³¹

From the perspective of being inside the fund, undergoing training was not linked to promotion. In fact, undergoing training meant an official potentially losing up to 50 per cent of their compensation, as any person who underwent training could not claim overtime²³². So doing a cost-benefit analysis meant that there was limited motivation for being trained whilst working at Fund B.

Furthermore, some officials argued that the fund offered them very limited and irrelevant training opportunities in the first place. In particular training was seen to be impossible in the fund's branches. One official stated:

There was a corruption case that occurred in the Saudi northern province and was discovered by the protection borders, not by the fund's head office, because it was not within the sample [annually, the fund's head office takes a sample of projects that are approved and disbursed to its branches to ensure their compliance of the fund's policies and procedures] ... Sometimes when the head office officials inspect a possible corrupt application and would like to conduct an onsite visit to verify the existence and compliance of these projects, some branches' officials say, 'we don't know the location of these projects as we were not trained on how to use the navigation systems', leading

²³⁰ Personal communication with interviewees 37 and 42

²³¹ This paragraph and subsequent paragraphs are based on personal communication with interviewees 37 and 50

²³² Personal communication with interviewee 37

them to not write (or sometimes write the wrong) location signals ... Since I joined the fund [almost 30 years ago], we have requested training many times, but they [the management] responded by saying 'you have on-the-job training and you should build your experience as you work in the fund'. We requested training in how to use the computer systems, so they gave us one comprehensive training session, but it was too advanced. One of my colleagues sat at the back and started chatting with another person because they understood nothing. They should have had a placement test before determining the most appropriate training program... it was clear that the fund had no direction or desire for training. This is evidenced by the fact that many training opportunities were offered to the fund, but they were locked in the drawer [the managers kept them in their desks]. The director of the department did not want to send any of his employees on training programmes because he did not want to lose them while they had work to do, as this may have affected their workflow negatively and increased the load on the remaining employees. Plus, he would tell us that we [the employees under his supervision] would not study and attend the training programs even though there were attendance records taken on these training programs.²³³

Interviews with senior management revealed the opposite side of the story. One senior manager defended Fund B's position by stating that:

Before 1430 H [2010 AD], the fund did not have sufficient money for training... In 1430 H, the fund allocated a budget for training with much emphasis on scholarships... yet, most employees who went for training, did so outside Riyadh so that they could have fun and benefit from travel allowance. Employees who were assigned to training in Riyadh refused to attend because the training was not linked to promotion or annual bonuses [plus they had no travel allowance]; therefore, all training sessions were cancelled with the aim of revising the fund's promotion and annual bonus policies to somehow link them to the training being successfully completed by the fund's officials.²³⁴

This official went on to explain how corruption in recruitment affected their own attitude towards training:

All past recruitment was bullshit... the fund's officials participated in an English training program offered by... [Fund A], and all our [new] employees failed, including one person who had a masters' degree from the UK!!... The fund's workload has significantly reduced [because the fund no longer supports certain projects], so why should the fund train employees who have nothing to do.... If you visit anyone in the fund, he will tell you 'I have a problem with training.' Personally I had only one training programme so everyone should be able to rely on self-training... The fund had a plan to start with... [Fund A], yet most of our officials could not speak English. Now, any employee can go and study English in the evening, and the fund will fully reimburse him, but only if he passes the English course. In the past, the fund brought in an English teacher, yet there was no benefit of doing so as the employees chatted and had

²³³ Personal communication with interviewee 51

²³⁴ Personal communication with interviewee 50

fun during the English course. Then, the fund gave a financial guarantee for any employee who wanted to study English in any English Institute, yet employees started English courses and never completed them successfully. Nowadays, employees are asked to pay for themselves and the fund will fully reimburse them only if they pass the English course²³⁵

Although most of Fund B's officials were unsatisfied with the limited or non-existent training, there was little to no staff turnover within the fund. The high retention levels could be attributed to the following factors: first, the fund's salary scale was higher than the civil service salary scale; and second, most officials had either very little or no work to do which gave them the opportunity to work outside the fund for extra money. What made this worse was that the fund's policy did not prohibit its officials from working in the private sector whilst working in the fund. Furthermore, it was considered totally acceptable, and common practice, for employees to apply for the fund's loans, as they perceived themselves as citizens and therefore had the right to benefits from the funds just like any other citizen.²³⁶

Therefore, it appears that one root cause of corruption within Fund B is corrupt recruitment coupled with weak training. It is clear that without enforcing policies to recruit on merit, a large number of officials could be recruited through influence and nepotism, leading to the perception by some officials working within the fund that as corruption is tolerated by senior management in the recruitment process (which they must assume or they would not have been appointed), therefore it is most likely that other forms of corruption will be tolerated. This was further exacerbated by the fact that non-merit based recruitment led to staff being less motivated to engage with training programmes to improve their abilities. In turn, this resulted in inadequately trained internal auditors, with the consequence that enforcement of policies and procedures is less effective, therefore potentially swamping their ability to separate deliberate corruption from procedural failure by officials.

²³⁵ Personal communication with interviewee 50

²³⁶ Personal communication with interviewee 42

4.2.9 Accountability

Although the director general was perceived to be strict with all officials to ensure that they were in compliance with the fund's policies and procedures²³⁷, his actions towards corrupt employees actually showed his high level of tolerance for corruption. In the past, many corruption cases were discovered in the fund, mostly in its regional branches, yet in none of these cases were corrupt officials asked to leave the fund nor did they have their contracts terminated. This does not mean that corrupt officials went unpunished, but instead, they were usually removed from their positions. For instance, if they were at managerial levels, they would be down-graded to employee level, but without decreasing their salary scale (in other words, their responsibilities and commitments were reduced yet they maintained the same salary). In the worst case scenario, these corrupt officials would be reallocated to different cities, far from their families and hometowns. In some cases, corrupt officials would be kept in their positions but would be given written warnings and have a few days' deductions from their salaries. For instance, in one corruption case it was found that an employee approved the disbursement of a loan without conducting an onsite visit to verify that the loan applicant had completed the projects and was therefore entitled to receive the full value of the loan. This official had one week's pay deducted from his salary²³⁸. Although it was clear that this kind of punishment was weak, the fund did not take serious measures against corrupt officials for a number of reasons, such as: similar corrupt practices had been discovered in the past, yet these corrupt officials were not fired so a precedent of slack punishment had already been set²³⁹; and the lack of competence within the Internal Audit Department, and the large number of non-compliance cases for them to investigate led to difficulties associated with differentiating corrupt practices from merely negligent ones. In many of these cases, the officials could argue that they had approved the application out of negligence rather than for monetary gain, however, the counter argument to this is that there were many indicators to show that these corruption cases were ideal examples of officials abusing their positions for private gain. The first indicator was that these corruption cases usually occurred in the fund's regional branches where most, if not all, employees had

²³⁷ Personal communication with interviewee 44

²³⁸ Personal communication with interviewee 43

²³⁹ Personal communication with interviewee 44

tribal (or at least friendship) links with the loan applicants due to the fact that many of these branches were located in rural areas (i.e. small towns and villages). So it was more likely that any violation of the fund's policy would be considered as a form of favouritism toward loan applicants by these officials, rather than corruption for monetary gain. The second indicator was that almost all of the fund's branches had a low volume of work, with some of the branches having no work to do at all. As negligence would usually occur as a result of an overwhelming amount of work, which was not the case in the fund's branches, it would appear unlikely that non-compliance in these areas could be the result of incompetence or overwork.²⁴⁰ The third indicator was the fact that the investigation of many corruption cases uncovered concerted efforts by many of the loan applicants to cover up for corrupt officials, to the extent that many applicants had rebuilt their projects to make them fulfil the criteria.²⁴¹

The fund's weak accountability could also be attributed to the director general's perceived attitude that he did not want to seriously harm officials by firing them because most officials had families upon whom they relied. Also, weak accountability could be attributed to the board's inactive role in holding the director general accountable for his inadequate actions against all previous corruption cases. This could again be related to the board's independence (or lack of it) and the conflict of interest that existed between the board and the director general.²⁴² However, the board's oversight did improve slightly over the three years from 2013-2015; for instance, it established an audit committee, which consisted of board members and externally appointed, highly qualified and reputable, internal audit experts, which led, to some extent, to the empowering of the Internal Audit Department.²⁴³ The audit committee questioned senior managers who violated the fund's manuals or did not cooperate with the Internal Audit Department. One senior official pinpointed that:

Fund B's director of investment was questioned by the audit committee for limiting the Internal Audit Department's access to his department. His defence was the confidentiality and sensitivity of Fund B's investment portfolio and decisions.²⁴⁴

²⁴⁰ Personal communication with interviewee 36

²⁴¹ Personal communication with interviewee 44

²⁴² Personal communication with interviewee 42

²⁴³ Personal communication with interviewee 37

²⁴⁴ Personal communication with interviewee 33

However, so far the Internal Audit Department has not been granted full access to review Fund B's investment transactions, even though there was a clear instruction from the audit committee to allow them to do so. This questions the usefulness of the audit committee whilst the director general is the gate-keeper between the Internal Audit Department and the audit committee, and also highlights the potential for abuse of the power entrusted to the director general as the vice chairman of the board and a member of the audit committee. So, within Fund's B setting, it appears that the audit committee played a consultant role, as the director general completely controlled what reports the audit committee could or could not see. In addition, the director general had full discretion in implementing or disregarding audit committee instructions because he oversaw and controlled all functions within the fund, including internal audit and investment, and he could empower the Internal Audit Department to review the investment transactions in the first place.²⁴⁵

In short, within Fund B there appeared to be three levels of accountability: at the first level, from the board to the director general, it was clear that there was no accountability at all; at the second level, from senior officials to the director general, there seemed to be a lack of accountability; however, at the third and lowest level of officials, the levels of accountability were between weak and reasonable, depending how well these lower officials were connected to the senior management. To illustrate this, one staff member in the Finance Department was commissioned to conduct an assignment in one of Fund B's branches; however, the Internal Audit Department discovered that he never conducted the assignment. The Department was unable to hold him accountable because his manager stood by him, and he was only requested to pay back his travel expenses.²⁴⁶

From an internal audit perspective, there appeared to be an avoidance of confrontation with senior managers because these managers possessed a great deal of influence over the internal auditors' future career prospects, including promotion and training. In fact, one senior manager made it clear to the internal audit team who rigidly scrutinised his department and seemed to excel in discovering violations, by saying:

²⁴⁵ Personal communication with interviewee 33

²⁴⁶ Personal communication with interviewees 33 and 43

Do not put us in a position where we have to replace one of the internal audit team or change the internal audit team leader.²⁴⁷

Throughout the fieldwork of this research, it was clear that fear of accountability came from outside rather than inside the fund. Many officials from Fund B refused to be audio taped out of fear that their interviews might be leaked to social media, especially Twitter.²⁴⁸ As narrated by an official:

Many officials in the fund's branches treated our findings with negligence. Sometimes, they would tell us that they had corrected procedures as a result of our findings, but when we re-visited them we found that they had done nothing.²⁴⁹

Therefore, the lack of accountability within Fund B was clearly a failing that allowed corruption to continue within the fund, as officials were more concerned about exposure from external sources, such as social media, than they were about being punished internally, where there appeared to be a reluctance to confront, punish, and publicise the punishment of officials caught out engaging in corrupt practices. Therefore, strengthening this one key area would be likely to reduce the levels of corruption within Fund B.

4.3 HARD CONTROL ANTI-CORRUPTION STRATEGIES

4.3.1 Risk Assessment

As mentioned previously, experts from a developing country handled Fund B's set-up process, developing the fund's internal control, based on their experience of working in a similar government organisation in their own country. Their approach to tackling corruption was centred on an old saying from their own country: "uncontrolled money teaches us how to steal."²⁵⁰ Based on this quote, which was repeated several times during interviews with Fund B's officials, the experts recognised that money had an inherent power that could exercise control over individuals. The implication was that

²⁴⁷ Personal communication with interviewee 37

²⁴⁸ Even though the researcher assured these officials of confidentiality as no information will be included in this research that might lead to identify either their organisation or themselves.

²⁴⁹ Personal communication with interviewee 33

²⁵⁰ Personal communication with interviewee 45

when authority or control over money was absent, the fund's officials would inevitably embezzle government money or use it immorally. The same applied for other types of corruption: uncontrolled public officials would trigger the motivation of these officials to abuse their positions, or would at least tempt them into corruption once they had the opportunity to be corrupt without being detected. Therefore, it is safe to say that, historically, the fund relied heavily on hard internal control rather than soft internal control as its main defence against corruption.²⁵¹ This could be linked to the fact that all of these experts were brought from a country which had been constantly ranked as having systemic corruption in well-known indices such as the Corruption Perception Index and World Governance Indicators. As a result, the experts appeared to place less interest in soft control such as tone at the top and training, and more in hard internal control anti-corruption measures, such as the separation of powers, because the experts' assumption was that officials would abuse their positions any way they could once they had the opportunity to do so, regardless of their background, level of training, or institutional culture.

Although hard control appeared to be the strongest aspect of Fund B's internal control, it was still perceived not to have been as good as it should have been. In particular, the fund followed the old school of management by taking a reactive, rather than a proactive approach to managing the fund's activities. To put this in the context of corruption, the fund did not carry out a risk assessment or scenario analysis to identify internal control weaknesses that could open the window for (or facilitate the introduction of) corrupt practices. Instead, the fund would wait until corruption had occurred, then take corrective measures by modifying its internal control, only to the extent that this corruption case could be prevented from happening again. For instance, before 2004, the fund's branches were authorised to approve and disburse any loan application below USD 133,000, yet there was no mechanism in Head Office to monitor whether these applications were processed properly.²⁵² This clear loophole in internal control could have been easily identified if the fund had undertaken any risk assessment. In 2004, the senior management became aware that some branches' officers

²⁵¹ Personal communication with interviewee 33

²⁵² The fund assumed that all loans must be paid back at one point in the future as there was no bad debt for government loan (if debtors were bankrupted, they would still be liable for the government until they paid back the loan. If the debtors died, usually the government would pay back the loans to the fund).

had systematically abused their positions by making loans under fictitious names, or by making loans for relatives and friends who did not fulfil the necessary criteria. In response (to mitigate the branches' corruption risks), the fund established a specialist department at head office to review the compliance of all branches with its policies, procedures, and circulars.²⁵³

Having such a reactive approach not only encouraged corrupt practices (or at least failed to discourage them adequately), but also hindered the fund's ability to protect its assets. To illustrate this, in the past the fund would accept a personal guarantee for USD 800,000 loans, despite the fact that its policy on this was to only accept real estate as collateral. It was only many years later that the fund discovered that this policy was not being enforced when many debtors (along with their guarantors) failed to pay back their loans. In this case, the fund took corrective action, but only after hundreds of millions of dollars had been lost, never to be recovered.²⁵⁴ A more pro-active approach would have identified the risk of this happening, and ensured that the rules on collateral were actively followed and enforced, protecting many millions of dollars' worth of the fund's assets.

It should be noted that with the establishment of the audit committee in 2013, the concept of risk management started to emerge, although as the following interviews demonstrate, there still appears to be plenty of progress to be made. The committee asked the Internal Audit Department to prepare a road map for adopting a risk based internal audit approach to auditing all of the fund's departments and activities. One official commented:

The director of the Internal Audit Department asked [his staff] ... to prepare a response for the audit committee's request. Yet, honestly ... [the internal auditors and the director of the Internal Audit Department] had no idea how to develop a risk assessment manual.²⁵⁵

The official went on to explain why the Internal Audit Department was not in a position to develop a risk based audit plan, stating that:

The director of the Internal Audit Department had no accounting qualifications or experience...and did not know how to audit basic accounting journal adjustments and closing entries; how would you expect this person to know

²⁵³ Personal communication with interviewee 36

²⁵⁴ Personal communication with interviewees 33 and 36

²⁵⁵ Personal communication with interviewee 33

anything about risk based audit...In the past, ... [internal auditors] hardly had any training, yet with the newly established audit committee, training and incentives to obtain professional accounting and auditing certificates were introduced...However as of now, no one in the department [Internal Audit Department] has a professional accounting or auditing certificate... It has been more than six months since the audit committee's request... and yet [the director of Internal Audit Department] has started to google 'risk assessment' just to understand this concept so that he can write something to the audit committee.²⁵⁶

A few months later (at the end of the fieldwork), another official indicated that the Internal Audit Department wrote to the audit committee to seek their permission to prepare a request for tender from professional accounting firms. Based on this tender, the accounting firm would be requested to develop a risk based audit methodology and guideline for the fund²⁵⁷.

However, the benefits of applying risk based audit can be limited, as it requires competent officials to carry out this function. In other words, adopting a risk based audit strategy requires officials to have professional skills in order to be capable of identifying different types of risks and then to address them. With the current poor capacity management, which was observed throughout the interviews of this research, many officials were not aware of the meaning of some of the basic concepts of management, such as code of ethics, internal control, and internal audit, therefore it is highly unlikely that risk based audit terminologies such as risk appetite, inherent risks, and residual risk would be understood. In fact, a number of Fund B senior officials were still struggling with how to use the computers, with one official stating that:

It is not only that they [the senior officials who do not know how to use the computer] do not have the basic skills to use a computer, they also defend their positions by downgrading the importance of using a computer as they think computers are not needed in the fund's business!!²⁵⁸

Another challenge to adopting a risk assessment approach was the institutional environment and setting in the fund, as implementing this approach would have required the engagement of all related parties and support from the senior management. This included having multiple brainstorming sessions with senior management and front line officials on possible corruption risks, the likelihood of their occurrence, and how could they be mitigated. Such engagement was unlikely to occur in a work place

²⁵⁶ Personal communication with interviewee 33

²⁵⁷ Personal communication with interviewee 46

²⁵⁸ Personal communication with interviewee 47

with weak communication, weak loyalty to the fund, and a fragile commitment to the fund's policy and procedures. What made it worse was the senior management's negative attitude towards applying a risk assessment, as one senior director stated:

There is no need for risk assessment as the vast majority of the fund's activities are redundant and standardised and small in nature... we are doing fine without any risk assessment as our collection ratio is 87 per cent.... Risk assessment is needed in an organisation like Fund A where every day you get unique loan applications with different types of projects and products, which require huge loans and deep investigation and analysis.²⁵⁹

So it can be seen that up until 2013 (at least), risk assessments focusing on anti-corruption strategies were non-existent in terms of trying to predict where weaknesses in the fund might facilitate corrupt practices, and that they were only used in situations where corrupt practices had already occurred. Since 2013, when the audit committee was established, the fund at least started to address the concept of risk management but, as was demonstrated in interviews with officials, just introducing the concept without recruiting highly trained auditors (or providing adequate training to the current staff) was not likely to improve the fund's anti-corruption risk assessment strategy. Without enhancement of the fund's soft controls, such as setting the right tone at the top, even a highly trained Internal Audit Department with a professionally produced risk assessment strategy would not be as effective as would otherwise be the case.

4.3.2 Control Activities

This section describes control activities as they are both designed and enforced in fund B to tackle corruption, namely transparency and checks and balance.

4.3.2.1 Transparency

Taken at face value, with regard to its website Fund B had a reasonable level of transparency in its core business, as the website detailed the loan process and all the required documents. It also delineated all types of projects that the fund was targeted to finance, the conditions required to be met in order to obtain the fund's loans, and how

²⁵⁹ Personal communication with interviewee 45

to pay them back. Moreover, it enabled loan applicants to track their loan application online.

However, the website seemed to be out of date as it did not reflect any major changes in the fund's policies, such as increasing the loan limit to USD 53.3 million. It also did not inform the loan applicant of their right to ask for certain exemptions. For instance, there was no mention that applicants could request changes in how the loan was calculated. Having so little transparency in these major changes and the right to exemption of the loan calculation had a negative impact on the soft control anti-corruption strategy, as only a few businessmen, mostly related parties (including the chairman of the board), were aware of such changes and received any benefit from them. This led many officials to think that such changes and exemptions were only intended to benefit these related parties and were not open for everyone²⁶⁰.

In terms of its support functions, the fund had little transparency on its website. Unlike most semi-independent Saudi government organisations, it neither announced its vacancies nor allowed job seekers to apply online. This could be linked to the senior management's apparent desire to keep job opportunities solely for their close relatives and friends as it would be more difficult to justify the filtering down (or eliminating) of thousands of job applicants with excellent academic backgrounds, combined with solid experience, for vacant positions, in favour of those who had good connections in the fund.

With regard to the fund's public procurement, only four of its previous requests for tenders were listed. The dates for opening the envelope were clearly stated to be in early 2015 and yet the names of the winners were left blank, even though these projects should have already been awarded to those companies who were successful in their tenders. It is unclear why the fund did not update its procurement website: negligence could have been one possible reason, but equally it could have been to hide the names of the companies that won the tender.

Throughout the fieldwork, officials seemed to be open minded regarding the sharing of the fund's documents. One senior director stated that, "we have nothing to hide in our

²⁶⁰ Personal communication with interviewees 42 and 51

desks.”²⁶¹ Thanks to their transparency, this research was able to uncover what is called ‘decoupling’ in organisational studies. Decoupling in the fund represents the gaps between its actual practices and its manuals. These gaps appeared to exist because they help the executive management to obtain some legitimacy over the fund’s activities. This was clearly noticed within the fund’s internal audit manual, which stated that the internal auditors should report directly to the audit committee, yet in reality they never did so, but instead, their reports went to the director general who would modify, and sometimes completely block, some of these reports²⁶². Surprisingly the internal audit manual, which articulated the reporting lines for internal auditors, was prepared under the direct supervision of the director general, who gave both his blessing and his initial approval to the internal audit manual before it was brought to the board’s attention and gained their approval. It seemed that the director general had decided to have this high level of independence for the Internal Audit Department - at least on paper - as it had become common practice and the expectation for all Internal Audit Departments to report directly to the newly established audit committees in the Saudi public sector. Moreover, with this reporting line, the managing director showed external monitoring bodies, such as the external government auditor, the fund’s high quality board oversight²⁶³. This could provide assurance to the external government auditor that there was high management compliance with all relevant laws as they were monitored by the board, while in actual practice there was a lack of board oversight as there was limited means for the board to monitor the performance of the management, as discussed earlier in this chapter.

Decoupling might have contributed to a wider level of corruption in the fund as it may have sent the wrong message to officials who might have disregarded the fund’s policies and procedures for private gain. If the executive management intentionally maintained this decoupling (the gaps between what the manual said and what they did), how would they ensure that officials at the lower end of the hierarchy abided by the fund’s rules? It could be argued that the fund was able, to some extent, to do so by implementing rigid checks and balances, which is discussed in the following section.

²⁶¹ Personal communication with interviewee 45

²⁶² Personal communication with interviewee 33

²⁶³ Personal communication with interviewee 8

It can therefore be concluded that there was a level of transparency with regard to the loan application process as documented on the website, and as to how much access the researchers were allowed to the policies and procedural documents of the fund. However, this must be tempered with what was not included on the website. In particular, the failure to publicise the increase in the loan limit – especially when taking into consideration, as discussed earlier, that one of the first beneficiaries of this change was the chairman of the board’s company – adds to the perception that corruption (or at least conflict of interest) is tolerated within the fund. This perception was strengthened by the omission of the process by which loan applicants can appeal to have the loan amount calculated – which again seems to have been to the benefit of applicants with intimate knowledge of the fund’s internal workings and to the detriment of those without it.²⁶⁴ Without full transparency the feeling is that the fund will continue to be seen as acting more in the interests of the board and the executive management rather than in the interests of the Saudi economy as a whole.²⁶⁵

4.3.2.2 Checks and balances (separation of powers)

The fund’s policies and procedures manuals set out all the checks and balances that should have prevented officials from being corrupt. However, considering that these manuals seem to have been initiated by officials from a less developed country than Saudi Arabia, they are “full of gaps and loopholes”, as was remarked on by more than one interviewee.²⁶⁶ Since its establishment, the management of the fund has updated these manuals to close or eliminate these gaps as needed, including to eliminate or reduce the opportunity for corruption. One official explained this by saying:

The foundation of segregation of conflict of duties [separation of powers] was weak... This led to several corruption scandals, which were discovered and reported by outsiders.²⁶⁷

To support his statement, he offered the following example:

One embezzlement case was discovered when borrowers filed complaints to the head office about receiving requests to pay back their outstanding loans,

²⁶⁴ Personal communication with interviewee 41

²⁶⁵ Personal communication with interviewee 42

²⁶⁶ E.g. personal communication with interviewees 33, 43, and 46

²⁶⁷ Personal communication with interviewee 33

even though they had already cleared the whole loan balance. After a full investigation, it was discovered that one of its collection managers had been relocated to a different branch. The manager had been in control of *both collection and accounting functions* in his previous position, and had been collecting cash from borrowers and giving them stolen receipts. At the same time, he had failed (or more likely neglected) to update accounting records or send borrowers follow up letters regarding their outstanding balances. When a new collection manager was appointed, he started to bill borrowers for their outstanding balances based on the accounting records.²⁶⁸ [Italics from the researcher]

Three lessons could be learned from this case. The first one is that corruption (especially in the form of embezzlement) can be expected if the basic concepts of checks and balances are violated. Checks and balances dictate that different employees must always handle authorisation, custody, and record keeping functions. The collection manager engaged in corruption because he was in control of two conflicting roles: cash collection (custody) and accounting (record keeping). Therefore, this corruption case clearly supports the research hypothesis (corruption = internal control deficiency). Another lesson that could be drawn from the above example is that job rotation might have had some effect on alleviating the consequences of weak checks and balances – indeed it could be considered a check on corruption in itself. If the collection manager had not been relocated to a different branch, he might have been able to hide his corrupt practices. This was especially true in Fund B where there was weak control over its official documents, which was evident from the stolen receipts as the collection manager was able to trick the head office official and obtain extra cash receipt books. This occurred because the head office official trusted that the collection manager would tell him how many books he received when he handed him them (basically the head office official would ask each branch's employees face to face how many books they needed, then the head office official would count the number of books and hand them over to the collection manager. The collection manager in this case received 11 books but wrote down that he had received only 10. So, he abused the trust placed in him by the head office official). Surprisingly, the head office internal control mechanisms, such as internal audit, did not notice this mismatch between the number of books handed to its branches and those available at head office. This confirmed the research findings

²⁶⁸ Personal communication with interviewee 33

regarding a weak Internal Audit Department²⁶⁹ (which will be discussed in more detail later in this chapter).

Although most corruption cases arising from weak checks and balances had been, to some extent, addressed in the past five years, others still existed such as collecting cash from borrowers instead of requesting them to deposit money directly into Fund B's bank account. Fund B continued to accept cash in this way because the executive management claimed that some borrowers were uneducated, and so it was much easier to collect cash directly from them in order to improve Fund B's performance in terms of debt collection and decreasing bad debt.²⁷⁰ However, one internal auditor highlighted that "this is a loophole in Fund B's internal control that has been abused several times. It should be closed as soon as possible. All borrowers should be forced to pay back their debts directly into Fund B's bank account."²⁷¹ He supported his argument by illustrating a number of examples, including a recent case of embezzlement by a finance manager in one of Fund B's branches. The finance manager had been receiving cash from the Collection Department without updating the accounting records. This case was easily discovered because all borrowers' payments were recorded in the Collection Department's books. Again, this was discovered when borrowers complained about their outstanding balance.

The conclusion here must be that Fund B's checks and balances require strengthening and more rigid enforcement. Some of the changes that would prevent a great deal of the examples of corrupt practices outlined in this section should be simple to implement – for example the fund could stop cash collection by officials and insist that all loan repayments are made to Fund B's bank account. The idea that loan recipients are so lacking in education that they can only deal in cash does not appear to stand up to any serious scrutiny as the loan applications are themselves complicated enough to require a high standard of education to complete, and the funds are not disbursed in cash but via bank account. In general, it can be concluded that, despite the progress that Fund B has made in this area, there are still areas in which they could improve the anti-

²⁶⁹ Personal communication with interviewee 33

²⁷⁰ Personal communication with interviewee 48

²⁷¹ Personal communication with interviewee 33

corruption controls by ensuring that the power to collect cash is separated from the task of accounting for its collection.

4.3.3 Control Activities over Technology²⁷²

Fund B's information technology systems were established at the formation of the fund by technical experts from the developing country that was instrumental in setting up many other areas of the fund. In the past decade, Saudi government policy has been to recruit more Saudi nationals to work within their government departments. However, the fund's policy was to contract out their IT provision to a commercial organisation, with the proviso that they sponsored the experts from the developing country to continue working in the fund. This also meant that when the outsourced contract was given to another commercial organisation when it expired, the new IT provider was expected to still sponsor the same IT experts, who remained working in the fund's IT Department despite the change in IT contract provider. Senior management made this decision because they thought that it was better to keep these experts for the following reasons:

Firstly, the IT contractors had excellent knowledge of how the system had worked since its establishment as they had built the HR, finance, loan, training, procurement, and archiving systems. Not only was this the case but, like Fund A, these systems were built internally, specifically for the requirements of the fund, yet they were not integrated with each other, meaning that Fund B now has a number of incompatible IT systems.

Secondly they could speak Arabic, which was considered important as most Fund B officials did not speak English.

Thirdly, they were able to pay the contractors low salaries since they were from a poor, developing country and had lower salary expectations than IT contractors from North America or Europe would have had.

Fund B's IT systems were perceived to be out-dated and weak and no longer fit for purpose, but senior managers (most of whom had little in the way of IT skills and were

²⁷² This section is based on personal communication with interviewees 47 and 52

inherently conservative with regard to changing their processes through increased automation) insisted that the same IT contractors continue working in the fund, regardless of which commercial IT firms have the outsourced contract.

Despite this, senior management appeared to have some awareness that their systems were not as effective as they should be as, when attempting to analyse the effectiveness of the fund's IT, the researcher's requests to interview these experts were rejected. This would suggest that senior managers were not keen to open up the effectiveness of their automated processes to external scrutiny. However, there were some clear examples of how the fund appeared to be lacking with regard to control activities over their technology processes.

For example, the fund recently introduced the ability of loan applicants to follow the progress of their application on the fund's website. However, shortly afterwards the senior management were panicked to discover that an application had been released for android mobile phone/tablet users that linked directly to the section of the website that allowed applicants to follow their application's progress, as the development of this application had not been approved and no one in the IT Department had any knowledge of its development. It was later discovered that an official, hoping to impress the IT Department with a view to being promoted to a position there, had developed the application on his own initiative in his own time, and released it. The fact that an employee outside the IT Department was able to link a self-developed mobile phone application directly to the fund's website, providing access to a private area of the website without senior management having any awareness of this, would suggest that the controls over technology were not as strong as they should have been.

Another example is that of the inherent conservatism of the senior management, many of whom did not feel comfortable working with computers and IT systems, preferring to refer to manuals printed on paper. Therefore, when it became unavoidable to have information input into the IT systems to run management information reports, senior managers would provide their log-in details and passwords to their secretaries for them to update the IT systems. As a control on corruption, this breach of protocol could be seen to have potentially serious repercussions, as once this became common practice, the integrity of the IT systems became compromised. Any internal or external audit would therefore be unable to ascertain who had accessed the IT systems, control over

sensitive areas of management information would have been greatly eroded, and officials engaging in corrupt activities could potentially evade detection of punishment by either using someone else's log-in details, or using their own but then falsely claiming that someone else must have used their password to access the information.

A third example of the lack of control over technological systems within Fund B was demonstrated when the fund's website was hacked into. This breach of security could have had major repercussions for the fund, and demonstrated that the systems were not robust enough to withstand such an attack. The fund now claims that the new website is very secure and therefore is no longer vulnerable to being hacked.

Most importantly of all when considering the lack of controls over IT in relation to corruption, one must consider that many corruption cases mentioned above could have been discovered if the fund had implemented more robust IT systems and enforced their use by abandoning many manual processes. For instance, in the embezzlement case cited in the previous section, if the fund had implemented a computerised system for issuing cash receipt booklets to those officials in charge of collecting loan repayments, this corruption case might have been prevented from happening in the first place. The corrupt official would have found it harder to obtain an extra cash receipt book, and may thus have been deterred from even trying due to the considerably higher chance that an audit would have exposed his wrong-doing. In addition to this, if a computerised system of cash collection had been implemented with strict controls on authority levels for different functions within the loan collection process, the separation of powers preventing one person from controlling both the cash collection and accounting functions could have been enforced (always assuming that the abuse of the password and log-in systems referred to earlier in this section were also cracked down upon). Furthermore, the automated collection of management information, as well as providing senior officials with the data required to run the fund efficiently could also be used by auditors or those tasked with fraud prevention and detection to spot unusual trends that 'red flag' the possibility that embezzlement is potentially occurring. The example in the following section (4.3.4), where embezzlement by the fraudulent disbursement of funds for a portable piece of industrial equipment was spotted by the department preparing annual statistics, would most likely have been spotted earlier if

the statistics that flagged this corruption had been more readily available through computerised information rather than manually collected data.

So to conclude, it would appear that Fund B has weak control over its technology for a number of reasons. The fund started by employing cheap IT contractors from a developing country and allowed them to design IT systems from scratch on an *ad hoc* basis for the needs of the individual departments, rather than taking a holistic approach and having integrated systems across the entire fund. Having taken this approach, the lack of understanding of how IT systems could be used to enhance the efficient running of the fund, and the inherent conservatism of the senior management led both to the fact that the IT tender process was flawed by insisting on the retention of the contractors who had caused these problems in the first place (and seemingly making the tender process ineffective and virtually redundant in the process), and to the abuse of the logging-in process by senior management, making the setting of authorisation levels (and many other standard IT controls) virtually pointless. This last point could also be linked to other areas previously discussed, such as poor training programmes and the lack of incentives for officials to engage with them, meaning that the fund gave the impression that enhanced IT skills were not sought after, and the fact that no external or internal audit was carried out on the fund's IT procedures.

Stemming from all of the above, and most importantly of all, was the lack of recognition that properly implemented automation processes provide the means to reduce the opportunities for corruption to take place by enforcing the separation of powers by setting authority levels accordingly, providing more detailed management information to red-flag potential corruption in real time, and improving the integrity of the accounting processes as a whole, whilst providing accountability in all users of the IT systems – which also happens to be a powerful deterrent to engaging in corruption in the first place.

4.3.4 Rigidness of Enforcement of Policies and Procedures

An overall assessment of Fund B's policies and procedures revealed that the fund had problems with both the quality and the enforcement of its policies and procedures manuals. This again could be linked back to the quality of HR resources and the

institutional culture of the fund, as they were the main drivers, or at least had great influence over their development and enforcement.

Careful examination and analysis of the fund's manuals showed that its rules could be placed into two groups: 'core business manuals', which refers to the rules governing loan process handlings; and 'support function manuals' such as HR and internal audit manuals. In general, the fund's core business manuals were poorly designed, yet they were rigidly enforced at all levels. On the other hand, its support function manuals were both of poor quality in their design and were weakly enforced. To support this finding, a number of examples and detailed discussions are presented in the following paragraphs.

Starting with the core business, Fund B's loan handling process had several deficiencies in its design, as there were weak organisational processes for handling loan applications. This could mainly be attributed to the lack of step-by-step procedures and flowcharts that governed the loans process.²⁷³ Instead, there were very general guidelines for loan types and requirements - issued on 1 January 1998 and never updated since - as well as hundreds of circulars issued by the Minister of Finance and the director general over the last couple of decades. Credit analysts were expected to know all these circulars by heart. In order to cover for a situation where the credit analysts had not considered any relevant circulars in their assessment (perhaps because they had forgotten them or simply because they were on holiday when these circulars were issued), there was a very experienced credit analyst who reviewed all loan applications before they were reported to senior management. Once the loan application was approved, no one could question the integrity or compliance of these applications, including the internal auditors who were neither trained nor authorised to do so²⁷⁴. Due to complications surrounding the loan handling process, some credit analysts developed their own charts and checklists to help them process loan applications properly and accurately.²⁷⁵

Another deficiency in the core business procedures was discovered by a department responsible for preparing annual statistical reports for the board of directors, whilst they

²⁷³ While the researcher was waiting for an official to conduct an interview with him, one senior credit analyst in the fund asked his colleague how to calculate the energy ratio.

²⁷⁴ Personal communication with interviewee 41

²⁷⁵ Personal observations by the researcher

were gathering information from the regional branches on the financed projects. It became obvious in the preparation of this report that one branch was financing a specific type of project which aroused immediate suspicion that corruption might have been taking place. This particular branch had authorised a huge number of loans for a specific type of project in which the finished plant was portable. This allowed corrupt officials to exploit a loophole, as there was no procedure in place to identify which plant had been manufactured from a specific loan. Therefore, officials could (and did) approve a number of loans for this particular plant in the knowledge that if head office performed a site visit as part of an audit, the plant could be moved from another location to show that the loan had been spent on the correct project. In this way, the same plant could be used as ‘proof’ that there were many such plants in existence when in fact there may only have been a few. The portable nature of this particular asset also meant that in the event of a site visit by head office auditors occurring when the loan applicant was unable to move one of the few plants in existence to the site, he could claim that he had sold the plant – an excuse that would obviously not have been plausible if the plant was attached to the ground with foundations, as was the case with many of the projects that Fund B financed. This loophole might have led to officials entering into corrupt agreements with friends and family to apply for loans to finance the purchase or manufacture of this particular type of portable asset, safe in the knowledge that they would not actually have to spend the money on having the plant manufactured, but instead could use the loan for other, personal purposes. Once this statistical report had been seen by the director general, he empowered a task force to investigate what had been happening with a view to discovering the cause of this unusually high number of loan applications for one specific type of project, and to recommend the closure of any loopholes that might have allowed corruption to flourish.²⁷⁶

Another weakness in the core procedures in Fund B was the necessity to produce documents that did not add value to the application or project in the way that they were intended. For example, all loan applicants to Fund B had to produce a feasibility study to show that the project would achieve its aims and be financially viable – i.e. the applicants would have to demonstrate that the fund would, in all likelihood, see the loan repaid. Fund B’s procedures insisted that these feasibility studies were prepared by a

²⁷⁶ Personal communication with interviewee 33 and 45

specified (and very small) number of consultants, many of whom were either former officials at Fund B or had contacts within the fund. One senior employee highlights that:

These consultants are very well aware of Fund B's loan rules and processes because many of them used to work in Fund B's Credit Department. However, lately their work has become redundant to the extent that each consultant has developed a feasibility study format for every project. They just change the name and some basic client information and charge between 20,000 and 25,000 riyals per study.²⁷⁷

However, what Fund B's procedures did not ascertain was whether or not the loan applicant had the required experience and acumen to ensure that they could implement the projects that Fund B were financing. Therefore, this procedure appeared to do very little to improve the financial feasibility of the projects, and made no attempt to check that applicants could implement these projects, even if they were potentially feasible. It could therefore be suggested that this was a weak policy as it introduced an unnecessary bureaucratic barrier that helped to enrich former Fund B officials, but without improving the likelihood that the fund would see the loans repaid. Recently, Fund B acknowledged part of this weakness, and started to conduct interviews with loan applicants to ensure that they had the capability and the experience to implement these studies. One employee highlighted that:

During applicants' interviews, we check whether investors know how to run their businesses and market their products. We encourage them to conduct their projects in phases to test the market and become more experienced in the industry.²⁷⁸

The most obvious weakness in the policies and procedures at Fund B is in regard to employees of the fund applying for loans from it. It should be clear that there is potential for conflicts of interest in this area leading to the possibility of corruption, and yet Fund B has no specific procedure for dealing with loan applications from staff members, other than a mention in the authority matrix which dictates that branch managers should refer their own loan applications to head office to be processed. There is no policy to prevent a branch manager from allowing the branch to process applications from less senior employees, which has clear implications for reducing the level of corruption in the regional branches. Good practice would suggest that additional checks and balances

²⁷⁷ Personal communication with interviewee 38

²⁷⁸ Personal communication with interviewee 39

should be implemented when processing loan applications from officials working within the fund, which could (as is the case of Fund A) include the banning of this practice altogether. This lack of unambiguous loan application procedures for Fund B's officials is exacerbated by the fact that no policy exists to dictate that loan applications from board members should be treated with greater care, and have more rigid checks and balances, than applications from parties external to the fund.²⁷⁹ So this poor quality policy stems from the weak soft control that in this instance the tone from the top is lacking, as the opportunities for corruption by board members, plus the perception that they could be exploiting this weakness for personal enrichment, are greatly increased by this clear weakness in procedure.

Most senior management, on the other hand, seemed to be divided on the importance of introducing step by step manuals for loan handling processes. The first group appeared to be from the old generation who do not change and do not accept change. They claimed that the existing manuals were sufficient and a good fit for the fund's objectives as the fund had been - in their view - efficiently run, with no major issues.²⁸⁰ The second group thought that it was difficult to develop step-by-step manuals for all the fund's activities.

One senior official stated that:

It is simply impossible to develop policies and procedures that cover all Fund B's activities. In some cases, you have to reject loan applications or collateral by using a common sense approach. For instance, one applicant pledged a property for repayment of the Fund B loan, even though that property had no entrance because it was surrounded by other land that was held as collateral for another government agency. Although this property met Fund B's collateral requirements, it was rejected because it had no entry.²⁸¹

Another senior official questioned the usefulness of step-by-step procedural manuals as their utility wholly depended on the quality of officials in the fund. He supported his argument by stating:

When you send two of Fund B's examiners to the field with the same manual, they will come back with different findings depending on their qualifications and ethical values. One examiner will be very detail oriented and will follow the manual with his eyes open for any violations or risks surrounding the projects, while the other might be very lazy and not even get out of his car to

²⁷⁹ Personal communication with interviewees 38 and 40

²⁸⁰ E.g. personal communication with interviewee 41

²⁸¹ Personal communication with interviewee 44

check that the loan applicant fulfils the requirements specified in both the loan guidelines and the applicants' feasibility study.²⁸²

In contrast, the third group was in favour of introducing step by step manuals for all the fund's activities. In fact, they showed that the fund was suffering because of the non-existence of these manuals. For instance, it was not able to automate its services as the IT Department needed clear business charts and a written, detailed process to develop the system. One official stated that:

Just like many government organisations, the senior management does not differentiate between the role of a business analyst and a system analyst... [the IT Department] should be handed a step-by-step flow chart to deal with receiving a loan application through to loan disbursement, from which the IT Department could develop the Fund's system.²⁸³

Another example that showed the need for operational step-by-step manuals came from the HR Department. One official indicated that the fund intended to introduce a comprehensive orientation process for new employees. However, they could not do so because there were no step-by-step operation manuals from which training material could be prepared. So new employees had to learn by themselves from their assigned department (i.e. the department in which they have to work).²⁸⁴

One official contended that the fund's existing practice (poor design of its core business manuals coupled with weak training) contributed to a higher level of corruption, because credit analysts could easily find excuses for violating the fund's rules for private gains; as these rules were not gathered in one folder, they were not trained in them, and so could not be easily followed. However, this did not seem to be the case, at least at head office, as the level of perceived corruption in the fund's core business is low. This could be linked to the senior management's commitment to rigidly enforce all of the fund's manuals at all levels, even though these manuals were poorly designed. In the fund's branches, corruption was perceived to be higher in processing loans due to stronger tribal links (basically, the fund's branches were authorised to process any loan applications below USD 133,000 without referring to the head office). In some branches, where there were a small number of officials who had tribal links or friendships not only between themselves but also to the town in which they lived,

²⁸² Personal communication with interviewee 51

²⁸³ Personal communication with interviewee 47

²⁸⁴ Personal communication with interviewee 50

officials might adhere to social pressure and turn a blind eye by not conducting a field visit to verify that the loan applicants had bought the items for which they had applied for loans.²⁸⁵

Within the support functions, the weakness of the policies and procedures, and the weakness of their enforcement, were considerably worse than those in the core business. As mentioned previously, the HR manuals insist that all vacancies are externally advertised, but contain a caveat that the director general can appoint anyone without having a competitive recruitment policy, as long as he deems them to possess sufficient qualifications and experience. This caveat has been so loosely defined that it has made it possible for the director general to employ almost anyone without having to publicise the vacancy, allowing him to appoint family members without violating the law. Even though the director general only appears to have used this exception on one occasion – by appointing his nephew as chief financial officer - this lack of rigid policy has allowed, and possibly even encouraged, the most senior officials (including of course the CFO who appears to have been the main beneficiary of this policy exemption) to start overriding the merit-based recruitment policy and instead to appoint family members to positions within the fund. As this form of nepotism became more common place amongst senior managers, the weak enforcement of the merit-based recruitment policy allowed systemic corruption to take root in the HR Department, to the point that for the five-year period from 2010-2015, the majority of appointments to the fund were made based on family, friendship, or tribal influence, rather than on merit²⁸⁶. Other indicators of weak enforcement of poorly written procedures include the commitment to business hours by the majority of officials working within Fund B.²⁸⁷

To sum up, a great deal of improvement could be made in order to improve the rigidity of the enforcement of the policies and procedures with regard to reducing the levels of corruption within Fund B, as there is insufficient documentation of the policies that govern such key areas as the loan application process and recruitment of officials²⁸⁸. As a result of this, there are too many loopholes that could be (and indeed have been) exploited for personal gain and to the detriment of the effective running of the fund.

²⁸⁵ Personal communication with interviewee 36

²⁸⁶ Personal communication with interviewee 37 and 42

²⁸⁷ Personal observation

²⁸⁸ Personal communication with interviewee 40

With the grey areas that a lack of documentation inevitably allows, rigid enforcement necessarily becomes more difficult, and corrupt officials have a ‘get-out clause’ by saying they thought they were acting in the best interests of the fund and were allowed to use a great deal of discretion. As well as this, the caveat allowing the director general to effectively bypass the recruitment process appears to have allowed corruption in recruitment to flourish, and the loose definition of the caveat makes enforcement of a more rigid adherence to a meritocratic recruitment policy very difficult. Furthermore, some of the policy documents are clearly not fit for purpose, placing an unnecessary bureaucratic barrier between loan applicants and the funds that they wish to borrow, yet neither improving the efficiency of the fund’s administration, nor reducing nor preventing corruption. Therefore, this is one area where improvements in the level of control would almost certainly have a positive effect on the prevention of corruption within Fund B.

4.3.3 Information and Communication

4.3.3.1 Using relevant information

In general, the information gathering within Fund B appeared to be poor. This stemmed from the fact that even the core processes are not documented in a clear, step-by-step guide that all officials can follow. Changes to the loan procedures were published by circulars that were printed off and sent to officials.²⁸⁹ This led to a seemingly haphazard loan application process whereby officials would often document their own processes to follow, which would invariably differ from official to official. This would therefore create grey areas and loopholes for corrupt officials to exploit and also made the process of carrying out an effective internal audit much harder, as well as creating confusion as to whether any breaches of policy that occurred in the loan application process were caused by corruption or a lack of understanding as to what process to follow²⁹⁰. This problem was also exacerbated by the lack of record-keeping of decisions by officials that could be audited. Many officials could not even use a computer and refused (or showed no enthusiasm) to engage with training programmes in which they could learn

²⁸⁹ Personal communication with interviewee 41

²⁹⁰ Personal communication with interviewee 40

how to do so, which would allow them to record their decision-making processes which could then be audited by the Internal Audit Department. The main reason for this lack of computing ability and the refusal of staff to address this and improve their skills was because they were not incentivised to do so. There was no comprehensive training programme at Fund B and even if there was, with no incentive in terms of bonuses or pay rises, or even loss of employment to meet higher standards, many officials made a conscious decision not to improve their skills.²⁹¹

However, the main reason for the poor quality of information gathering within Fund B could be attributed to the poor quality of the officials working there. This again goes back to the systemic corruption within the recruitment process, whereby appointment is made as a result of influence rather than merit. This allows the appointment of less able officials than would be the case if recruitment were based on merit. One example of this was when a senior official was asked what was contained in Fund B's code of ethics, and he responded by saying:

We have a code of ethics, it is in the vision, mission statement, and objectives of the fund. You can see them in the annual report.²⁹²

This is a clear misunderstanding of what a code of ethics is and what it should contain. It became clear later that Fund B did not actually have a code of ethics.

Other interviewees highlighted the fact that the majority of senior managers did not have a background in business, and therefore were unable to see the importance of generating and using information and data for the strategies of internal control²⁹³.

Having said that, there seemed to be little link between producing high quality information to support the function of internal control and the level of corruption as even if high quality of information were produced it could still be manipulated by the executive management to hide corrupt practices. Therefore, the gathering and use of relevant information on its own, without addressing other deficiencies within the fund, is more likely to have a limited effect on the level of corruption.

²⁹¹ Personal communication with interviewees 50 and 52

²⁹² Personal communication with interviewee 45

²⁹³ Personal communication with interviewees 33 and 42

4.3.3.2 Communicating internally

The main channels of communication within Fund B appeared to be very old fashioned, using circulars that were printed out and sent to relevant officials²⁹⁴. Perhaps unsurprisingly, this method of communication appeared to be very ineffective as many officials were not updated with circulars that impacted on their work. For example, the Internal Audit Department were not updated on many occasions with changes in policies and procedures which led them to red flag many breaches in policies and procedures which were no longer in breach, as they had never received the relevant communication which updated these policies. This significantly weakened the role of the Internal Audit Department and might have increased the level of corruption, as corrupt practices could be hidden as a large number of these ‘breaches’ should not have been highlighted but would create extra work for the Internal Audit Department, reducing their ability to uncover deliberate breaches of policy for corrupt purposes. This also damaged the reputation of the Internal Audit Department as they were seen to be incompetent when they questioned legitimate transactions and missing corrupt ones.²⁹⁵

The communication between the executive management and the board of directors is generally perceived to be good within Fund B. This can be seen by the fact that the chairman of the board had his own office at the fund and usually spent at least one day there every week²⁹⁶. However, this practice is not in line with good governance practices because the chairman should supervise and evaluate the performance of the executive management, but as he works on daily operational matters (effectively working as an executive manager) his oversight function includes overseeing his own work. This is a clear conflict of interest as he is unlikely to uncover and highlight his own shortcomings.

Within the fund there appeared to be very weak communication between the board of directors and the executive management, with the exception of the director general, who seemed to be the only contact point between all executive managers and the board. Also, there was a gap in the communication between the director general and all employees as he did not hold any open meetings with the fund’s employees. In fact,

²⁹⁴ Personal communication with interviewee 41

²⁹⁵ Personal communication with interviewee 33

²⁹⁶ Personal observation

even the director general's communication with his senior managers seemed to be limited. If there were a channel of communication between the director general and all employees, he would have discovered that there was an unhealthy atmosphere, preventing competent, clean officials from working with enthusiasm and creativity. Since the director general seemed to run the fund with a centralised management style, he often appeared to be very busy and did not make time to listen to his lower level employees. One senior employee said:

We never saw the director general, except once when he came with the Minister of ... to show him around.²⁹⁷

The management style of the director general was to keep everything moving as it was, without looking too hard into improvements that might have proved difficult (but potentially worthwhile) to implement. This is seen in his decision to ask the internal auditor not to copy him with their audit findings on the auditees. Most of these reports contained serious breaches committed by either the auditee or the audited branches. So, if the director general showed this attitude towards his most senior auditors, common sense would suggest that whistle-blowers were highly unlikely to report any corrupt practices to him for fear of being exposed yet ignored. However, one could justify the director general's decision not to receive a copy of these reports for two reasons. Firstly, some findings of these reports were not accurate and as such the director general did not want to waste his time seeing the debate between the Internal Audit Department and audited departments, only a final summary once the discussion had been concluded. Secondly, the director general told the Internal Audit Department that they should not name and shame each department by informing the director general. Instead, they should work with audited departments in a conciliatory manner to ensure that they took any required corrective action. Another reason is that by copying in the director general on internal audit reports, he might be held responsible for knowing but not taking action to correct these findings. However, this responsibility would more likely come from external government bodies such as the external government auditor as the board could hardly have held the director general responsible considering his position and power over the board of directors.²⁹⁸

²⁹⁷ Personal communication with interviewee 42

²⁹⁸ Personal communication with interviewee 43

4.3.3.3 External communication

Fund B seemed to have a good relationship with the external government auditor, as they accepted recommendations and worked positively with the government auditors to address concerns and fix highlighted issues. This even went as far as the replacement of the head of Fund B's Accounts Department because they found a large number of mistakes within this Department.²⁹⁹

Fund B's communication with their external accounting auditor was more problematic. One of their former auditors highlighted the fact that in many instances they would be refused access to documentation from the Accounts Department that would back up some of their financial transactions. He stated that:

In these instances, we had to balance between the risk of giving a clean opinion that the financial statements represent the financial position of the fund fairly, and not obtaining the required documents to support this opinion.³⁰⁰

One clear lesson from this is that more openness toward the external accounting auditor is an indicator of less corruption, as the external accounting auditor is a client of the fund and therefore has to balance between continuing the business relationship with the fund and criticising their practices. However, this is less likely to be the case with the external government auditor as the fund has no power to appoint its auditing team and so it has no power or influence to wield to try to manipulate the outcome of the audit.

Fund B's relationship with the Saudi anti-corruption commission seemed to be beneficial to some extent as it gave Fund B officials the opportunity to meet with anti-corruption officers to discuss government regulations that applied to all government organisations, including Fund B, such as public procurement law and how it could be abused.³⁰¹

So, one can conclude that Fund B has mixed relationships with regard to its external communication. It appears to have a credible working relationship with both the external government auditors and the Saudi anti-corruption commission, yet its levels of corruption are still considered relatively high and these good relationships do not seem to have addressed any of the other problems that prevent the fund's officials from

²⁹⁹ Personal communication with interviewee 3

³⁰⁰ Personal communication with interviewee 8

³⁰¹ Personal communication with interviewee 33

engaging in corruption. In contrast, and as discussed in section (4.2.3), Fund B's relationship with the external accounting auditor appears to be open to potential abuse as they appoint an external auditor who relies on this contract financially far more than Fund B does, making the relationship unequal and therefore potentially open to corruption by putting pressure on to, at the very least, put a favourable spin on the fund's financial performance.

4.4 MONITORING CONTROL ANTI-CORRUPTION STRATEGY

4.4.1 Monitoring Soft Control

As discussed in earlier sections, Fund B's main focus has been on establishing hard internal controls rather than soft controls. Together with the fact that, up until 2015 at least, the monitoring of any internal controls was a clear weakness within Fund B (as the following section argues), this means that there is very little to analyse here as the implementation of soft controls has historically been weak within the fund and their mechanisms to monitor these have been almost non-existent.³⁰²

4.4.2 Monitoring Hard Control

Before 1988, branches outside of head office had their own internal controller, responsible for ensuring that all loan applications were compliant with policies and procedures. After 1988, these controllers were relocated to head office where they mainly focused on auditing petty cash expenditure and fixed assets, as well as authorizing financial transactions before they were paid by head office. However, Fund B's regional branches were authorized to spend up to USD 133,000, and their offices were authorized to spend up to USD 53,000, without referring to head office, so as a result of the way the internal controllers were empowered (or not empowered), this meant that regional branches and local offices could spend substantial amounts of government money without any further checks being made on whether it was being spent wisely, wasted, or even stolen.³⁰³

³⁰² Personal communication with interviewees 43 and 37

³⁰³ The paragraph and subsequent paragraphs are based on personal communication with interviewee 33

After 2010, Fund B was restructured and two departments were established: the Control Department and the Internal Audit Department. While the Control Department was responsible for pre-payment checking, the Internal Audit Department reviewed the accuracy, compliance, and integrity of record keeping and financial transactions. It also evaluated departments' performances. However, so far the Internal Audit Department has been limited to reviewing Fund B's performance in terms of collecting outstanding loans, so is not tasked with monitoring the existence of potentially corrupt practices, or allowed to do so, other than if there are any irregularities in the loan repayment process which may come to light as a result of their reviews. The Internal Audit Department reports to the director general, who hands over its report to the audit committee.

Since 2012, internal control and governance have improved dramatically. The board formed the audit committee in 2010, consisting of the director general, and three well-respected members. Fund B's audit committee empowered the Internal Audit Department by requesting that the following be designed and implemented to improve the fund's internal control mechanisms:

- An internal audit charter that clarifies its role and responsibilities.
- An annual training plan and incentives for obtaining professional auditing certificates.
- The establishment of two units besides financial auditing in the Internal Audit Department: an administrative internal audit unit, and a technical internal audit unit.

So far, the focus of internal audit has been on the procurement and collection of loans. The scope and findings of the Internal Audit Department are influenced by how good the personal relationship is between the director of internal auditing and other senior managers, which at the time of the research did not appear to be a healthy, functioning relationship. One internal auditor commented:

The director of internal auditing employs his power to settle personal disputes with other senior managers. These disputes are rooted in history as they worked together in the Financial Control Department.³⁰⁴

³⁰⁴ Personal communication with interviewee 33

There were numerous other problems with the way this Department was initially set up. For example, the director had personal issues with most of the senior auditors in his Department, which led to them being forced to either resign or move internally to other departments. This meant that new staff, mainly recent graduates (who were not likely to have been appointed on merit), made up the majority of staff in the department. Since the Internal Audit Department was established, no new staff member has been appointed with professional qualifications in auditing or accounting.

In addition to this, the director of the Internal Audit Department was not an accountant by profession and also had no previous audit experience. As a result, the director assessed the performance of the staff working in his department based on how many violations and mistakes they could discover in other departments, rather than using a more holistic approach by using his department to improve the performance of other departments through cooperation rather than coercion. These assessments have reshaped internal auditors' behaviour, making them more aggressive with other departments in order to find mistakes and violations. The findings of the Internal Audit Department became less accurate as a result because departments under audit did not cooperate with internal auditors in terms of providing the required documents and, more importantly, helping internal auditors to understand related policies and procedure manuals. Without fully understanding the manuals of each department, internal auditors, especially fresh graduates, came up with some inaccurate findings. This eventually backfired on the Internal Audit Department, weakening its role in Fund B, because the director of internal auditing lacked the competence to validate internal audit findings. Instead, he over-stated the findings of his staff. When the director general investigated the internal audit report, he found that that some reports were not accurate and others were misleading. This was largely as a result of other factors that have already been discussed in other sections. For example, the Internal Audit Department, possibly as result of their confrontational approach to their work and possibly because of the archaic way in which internal communication was cascaded to staff, often reported breaches of procedure based on out of date information. The confrontational approach also appeared to exacerbate this as the officials under audit were less likely to point out to the auditors that they were working with out of date policies. In addition to this, the fund's influence-based recruitment policy meant that sub-standard internal auditors were more likely to be appointed over more meritorious candidates, lowering

the standard of work in the department as a whole. This was also exacerbated by the lack of incentives for these sub-standard auditors to undertake adequate training in order to perform their roles adequately. As a result of all of this, and with the approval of the audit committee, the director of Internal Audit Department was downgraded by the director general and relocated to one of Fund B's branches.

There were also other issues with Fund B's monitoring systems. For instance, although each loan application had to go through a peer review in the same Specialised Loan Department, as well as an executive management review, no department, including the Internal Audit Department, had previously audited approved loan applications to check the eligibility of applicants in terms of meeting the requirements of loan guidelines or loan calculation methodology. Internal auditors were more focused on auditing the support function rather than the core business of Fund B. In fact, some internal auditors clearly stated that they were incapable of reviewing Fund B's loan activities and one claimed that:

We do not want to be embarrassed by auditing the Credit Department because we do not have the technical experience to audit this function and Fund B is not willing to train us in this area.³⁰⁵

This lack of expertise, and the lack of focus on monitoring the core business of the fund would appear to be one of Fund B's major internal control deficiencies.

Another issue was the decoupling that has already been discussed in a previous section. The director of internal audit should have reported directly to the audit committee according to procedural manuals, and yet in reality he reported directly to the director general. This made sense from a rational point of view as the director general controlled his promotion prospects and training budget and therefore was the most influential person with regard to his future career prospects, so the internal audit director would want the director general to know about any potential issues before going over his head to the audit committee.

Following on from the previous point, even if the director of internal audit reported directly to the audit committee, the lack of separation of powers within Fund B as a whole meant that the director general was a member of the audit committee and would

³⁰⁵ Personal communication with interviewee 33

still have had a major influence on protecting his own position from reports that questioned either his integrity, or his competence in maintaining the fund's integrity.

I must also return to the recruitment policy implemented in 2010 when Fund B was given independence in the area of staff recruitment. As has been discussed in section (4.2.8), recruitment should have been based solely on merit, but in reality this appeared to have been wilfully abused and ignored from the beginning. Part of the issue here is that the Internal Audit Department was set up to monitor financial performance only, not compliance with HR manuals. As one official noted:

Some unqualified applicants have been recruited... I can say that more than 50 per cent of fund B's employees were hired based on nepotism. It is normal to see a job applicant with excellent or very good GPA being rejected whereas job applicants with a lower GPA but with good connections are accepted.³⁰⁶

This meant that information asymmetry increased, allowing senior management to recruit based on influence without the board having the information required to ascertain whether or not this happened.

Furthermore, the researcher noted that the archiving room for the Internal Audit Department was very untidy, appearing to lack any organisation. This may seem like a minor point but together with the rest of the points made in this section, and the lack of computerised records due to resistance to automation within the fund, even if the Internal Audit Department were tasked with checking previous loan applications, it would find it an onerous task due to the lack of organisation to date.

Therefore, one could conclude that, whereas there appear to have been moves to improve the monitoring of hard control anti-corruption measures within Fund B in the last few years, there are still major improvements to be made. The most pressing issues are:

- The appointment of a director of internal audit with the requisite qualifications and experience, who could then insist on recruiting better trained staff, and implementing a more conciliatory, less confrontational approach to internal audit

³⁰⁶ Personal communication with interviewee 42 and similar comment made by interviewee 37

- The separation of powers so that the internal auditor reports to the audit committee, not the director general, and the director general no longer sits on the audit committee
- Empowering the Internal Audit Department to audit all the fund's functions, including but not limited to the HR Department's adherence to the recruitment of officials based on merit and reporting any failing to the board.

If these measures are implemented and properly enforced, it is likely that there will be a decrease in the levels of corruption in Fund B as, without proper monitoring, the information asymmetry in favour of senior management to the detriment of the board means that they will find it difficult to perform their oversight function correctly.

4.5 RECENT DEVELOPMENTS IN FUND B'S INTERNAL CONTROL AS OF 2015

After the end of the field work in July 2015, and during the process of verifying the transcripts with interviewees,³⁰⁷ it was found that there had been major changes in the fund's leadership, which had a significant impact on internal control and also confirmed the findings of the fieldwork.³⁰⁸

The first major change that occurred in Fund B, at the end of 2015, was the replacement of the chairman of the board. The new chair then undertook several major reforms, including the replacement of the director general with an external candidate.

The chairman also established the loan committee, whereby all loans exceeding the director general's authority (i.e. above USD 533,000) had to be carefully scrutinised by this committee. This decision is expected to contribute to lower levels of corruption, as the loan committee will have more frequent meetings and therefore will have the time to properly scrutinise each loan application to ensure its compliance with board directions and approved manuals.

³⁰⁷ E.g. interviewees 33 and 42

³⁰⁸ These changes touched upon many government organisations including Fund A and Fund B as part of the Saudi 'National Transformation Project 2020'.

Another change that was implemented was the decision to enhance the independence of the board by preventing the new director general from being either an audit committee member or the vice chairman of the board, thus establishing proper and clear separation of powers and duties between the board and its most senior official. This would provide the opportunity for the Internal Audit Department to act freely without any improper pressure from the executive management, thus strengthening its position and reinforcing the commitment to separate the board's oversight function from the director general's management function, and would also ensure that all internal audit reports would go to the audit committee without any modifications from the director general.

Other recent changes that have been implemented, arguably with a view to the longer term reduction of corruption within the fund (as well as increasing the efficient running of it) include the improvement of training for internal auditors, and implementing financial incentives for internal auditors to obtain professional auditing qualifications. As one senior official pointed out:

In the past, there was a very limited budget for training, but now Fund B pushes everyone to take training once every two years. It is up to the director of each department to decide when and what training should be given to his employees. The director of the Internal Audit Department was not very enthusiastic about training internal auditors; however, the audit committee requested a training plan for all internal auditors on CIA.³⁰⁹

Following this new direction from the board (which one could argue was the board's attempt to reset the tone at the top), the new director general started to replace the senior managers – a process he clearly intends to complete as he sent a verbal message that all senior management should be replaced by younger, more enthusiastic officials within six months. Moreover, the new director general enhanced the rigidity of checks and balances. For instance, he required three officials, instead of just one, to interview all loan applicants. All three officials had to sign the loan application before it was submitted to the senior management for approval. The implications for officials attempting to engage in corrupt practices in the core business here are clear – with three officials evaluating every loan it becomes much harder for a loan applicant to successfully bribe his way through the loan process and increases the likelihood that

³⁰⁹ Personal communication with interviewee 37

any official tempted to take a bribe would be caught, thus hugely increasing the disincentive to do so³¹⁰.

Although it is too early to evaluate the impact of all reforms taken by the chairman of the board, it is safe to say that from the sub-agents' perspectives, these reforms are more likely to cut down corruption dramatically. For instance, from the end of 2015 all recruitment activities were suspended until a reassessment was taken of the whole recruitment process. One official stated:

The new chairman along with the new director general seemed to be aware of corruption problem. Therefore, they only approved 20 new jobs in next year's budget [i.e. 2016].³¹¹

What can be learnt from Fund B is that the newly-appointed chair who was given (and was willing to exercise) power, had held a ministerial position, and was totally independent from, yet possessing extensive experience in, the private sector (as the managing director of one of the most successful companies in Saudi Arabia) was able to start to tackle the institutional corruption in just a few months. In other words, changing the principal from being inactive with questionable integrity because of his conflict of interest, to being a pro-active, independent principal with lengthy and relevant experience, and a proven record of success, was the cornerstone of starting to reduce the levels of corruption significantly in Fund B. However, although there is a plan to change most, if not all of the senior management, it is unclear how the new board is going to change the institutional culture and increase the competency of many officials who were appointed based on connections rather than merit between 2010 and 2015. However, follow up interviews suggested that corrupt officials refrained from any corrupt activities and were very worried about being held accountable to the new management. In other words, under the new, clean leadership (the principal and the agent), committed to setting the right tone at the top, and implementing the checks and balances and separation of powers, the rules of the game for the sub-agents have changed and they have to act ethically or face the consequences of being corrupt, which is more likely to lead to being sacked from the fund.

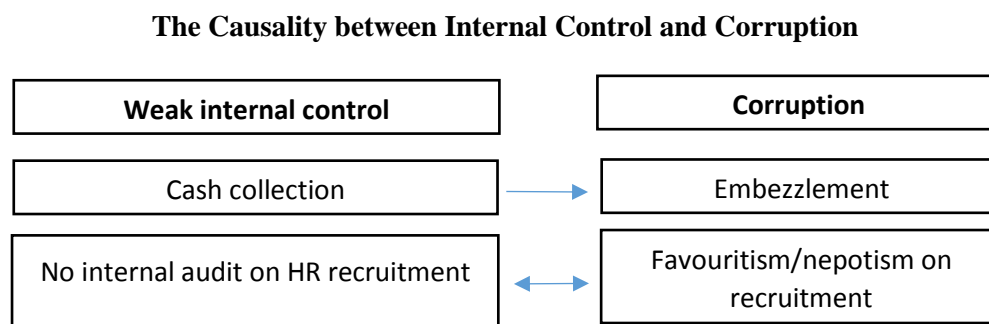
³¹⁰ Personal communication with interviewee 33

³¹¹ Personal communication with interviewee 33

4.6 CONCLUSION

Based on the corruption cases discussed above (and as illustrated in figure 4.1), one can conclude that the causal arrow between weak internal control and corruption can go both ways. In corruption cases arising from the fund accepting cash payment, there is a linear causality with weak internal control causing corruption, not the other way around (because this weak internal control arises from weak management not corrupt management). However, in support functions, there is circular causality with weak internal control causing corruption and corruption causing weak internal control. This could be clearly seen in the corrupt recruitment process as senior management appeared to favour weak internal control to hide their corrupt practices.

Figure 4.1



Also based on this analysis of Fund B, one can conclude that the more weaknesses there are in the three areas of internal control, the more likely it is that there will be systemic corruption. The recruitment process since Fund B was given the freedom to recruit its own officials illustrates this. Once Fund B was able to recruit independently of central government, some members of the board of directors and senior managers used this freedom to recruit family members to the fund, setting a tone at the top that allowed nepotism and tribal influences to be seen as more important than meritocratic recruitment policies (soft control strategy). This was exacerbated by the fact that internal auditors were not empowered to audit the recruitment process to ensure that only the most competent candidates were recruited to the fund (monitoring control strategy). Also, even if they were allowed to audit the recruitment process (which they were specifically not empowered to do), they would not have been able to do so because there was no clear, unambiguous policy for recruitment that the internal auditors could

check against (hard control strategy). Therefore, the recruitment process became compromised, seemingly allowing officials to be appointed based on criteria other than merit. This also meant that these officials would start working in the fund knowing that they had been appointed because of corruption within the fund, arguably making them more likely to believe that corruption was tolerated and therefore raising the likelihood that they would engage in corrupt practices themselves.

Therefore, I conclude that soft and hard internal control elements are interrelated. Having weak soft control (training and recruitment) led to weakened hard control as the quality of hard control was totally reliant on the quality of soft control. Moreover, the institutional culture of not recognising the importance of training, coupled with the way the procedure to award annual bonuses and promotions was set-up, discouraged officials from undergoing training, which led to them having outdated knowledge and becoming less enthusiastic to learn. This made the fund less able to implement risk assessments and identify weaknesses in its internal control as officials appeared to think that, as they would receive their salary anyway, there was no reason to put more effort into complying with hard controls for no additional reward. It is also apparent that giving authority to branches should have come with much stronger monitoring mechanisms than were implemented, as these appeared to be very weak.

The reason for having a higher level of corruption in Fund B in comparison with Fund A depends on which theoretical angle you look at Fund B from. This is addressed in the following chapter.

Chapter 5

Comparison and Conclusion

5.1 INTRODUCTION

The two preceding chapters clearly support the research's first hypothesis indicating that Fund A's stronger internal control led to lower levels of corruption than Fund B. From the COSO framework perspective, the following internal control practices mark clear distinctions between the two funds in their efforts to tackle corruption: tone at the top, commitment to competence, accountability, and procedural manuals with clear checks and balances that were enforced by continuous audit.

It is also clear that the relative strength of each Fund's internal control system contributed to its levels of corruption, and depended on historical background and organisational setting. In the case of Fund A, building institutional integrity, as per COSO soft internal control principles, was the first and most important defence against corruption, followed by hard control anti-corruption measures, such as well-designed and transparent policies and procedures. However, one thing that can be learned from Fund B is that the effectiveness of hard control relies on the quality of soft and monitoring internal control. Having highly effective soft and monitoring internal control is likely to increase the quality and enforcement of hard internal control, and vice versa.

This thesis applies alternative corruption theories to internal control elements that seem to make a difference in the level of corruption. This includes taking the most useful and relevant ideas from the most popular theoretical frameworks in the corruption literature, namely agency, rational choice neo-institutionalism, and historical institutionalism, to understand how each government institution reached its level of corruption.

This chapter discusses the strengths and weaknesses of each theoretical framework in light of the research findings in both case studies, i.e. whether each corruption theory can accurately explain and diagnose the different levels of corruption in the case studies.

5.2 LEVELS OF CORRUPTION

An overall assessment of the two agencies' internal controls confirmed the findings of the Saudi Corruption Index, in which Fund A was rated as the least corrupt government organisation, while Fund B had medium levels of corruption.

In Fund A, corrupt practices were minimal as the most questionable practices occurred in claiming for travel expenses and in taking excessive lunchbreaks. There was very little evidence of corruption taking place in the core business or support functions, such as procurement, recruitment, and lending practices³¹². In contrast, Fund B seemed to have systemic corruption in recruitment, to the extent that many interviewees believed that it was highly unlikely that anyone would be employed in the organisation without having good connections within the HR Department or someone in senior management³¹³. With regard to the core business, and taking into consideration the history of corruption cases in Fund B, this was found to be significantly higher than within Fund A, but was not considered to be either excessive or systemic.³¹⁴

5.3 THEORETICAL TRIANGULATION AND THE COSO INTERNAL CONTROL FRAMEWORK

Policymakers can draw many lessons from this research, but the most important one is that implementing effective internal controls in accordance with the COSO Internal Control Framework in government institutions leads to lower levels of corruption. However, such implementation of internal control is more likely to succeed in tackling corruption if policymakers look for insights from the following corruption theories: agency theory, rational choice neo-institutionalism, and historical institutionalism. These theories should be considered as complementary, rather than competing theories, even though their explanations of corruption differ, and sometimes clash. Nevertheless, in many cases, including the case studies of both funds, these theories provided

³¹² Personal communication with interviewee 32

³¹³ Personal communication with interviewee 37

³¹⁴ Details of these corruption cases were presented in the Fund B case chapter

complementary explanations of the impact of internal control on corruption, as will be seen throughout the following sections.

5.3.1 Agency Theory Explanation of How Internal Control Impacts Corruption

This section discusses two themes. The first (section 5.3.1.1) discusses the main differences in internal control between the two funds that seemed to impact on the likelihood of rational agents or sub-agents engaging in or refraining from corruption. The second (section 5.3.1.2) looks at the main features of agency theory.

A scholar of agency theory would explain that the low levels of corruption in Fund A compared to Fund B were caused by the relative cost of corruption within the two funds. This approach focuses on the hard and monitoring internal controls, and states that if policy makers raise the cost of engaging in corruption, they will lower the level of corruption.

An overall assessment of the cost of corruption in both funds concluded that for an official in Fund A there is a higher chance of being caught, fired, and prosecuted than in Fund B, which explains why the levels of corruption are lower.

5.3.1.1 Institutional incentives and corruption

The following section discusses how institutional incentives affected the levels of corruption in both funds. The focus will be on the internal control that seemed to affect, either positively or negatively, rational agents' and sub-agents' decisions to engage in or refrain from corruption. As explained in Figure 3.1, the agents of this study are the director generals of the two funds, and the sub-agents are the remaining officials.

5.3.1.1.1 Organisational structures

The first difference between Fund A and Fund B was in their organisational structures. Fund A only had one office based in Riyadh where all its officials worked and where

all the loan applications were processed³¹⁵, whereas Fund B had a much more decentralised structure with regional branches and offices across the country, which had responsibility for loans in their local area³¹⁶. Also, Fund A made a small number of loans each year (around 100-150) although these loans were of a complicated nature, whereas Fund B authorised a much larger number of loans each year in comparison (around 1,000).³¹⁷

In theory, having a decentralised organisational structure is a double edged sword. It could reduce corruption by speeding up and facilitating the procedures, which in turn eliminates opportunities for corruption. Yet it could increase corruption because a decentralised organisational structure is usually coupled with delegating authority, and giving discretion to officials, which could be abused by agents and sub-agents.

Within the context of this research, in Fund A it was easier to exercise oversight regarding some responsibilities because all loan applications were processed at head office and all loans of up to USD 8 million were approved by the director general (loans above this level required board approval)³¹⁸, whereas in Fund B the local offices could authorise and disburse loans of up to USD 53,000; the regional branches could disburse loans of up to USD 133,000, and the head office could disburse loans of up to USD 533,000. Any loans above these levels were passed to the board for approval.³¹⁹

These differences in organisational structures might have impacted the sub-agents' corruption cost-benefit calculations, as the probability of being caught increased when loan applications were processed in the head office, as many senior and knowledgeable officials, including the agent (the director general) and sometimes above a certain limit, the principal (the board of directors), had to scrutinise and approve them. By default, this increased the reward for corruption as these loan applications would have been large in nature as they were above branches' authority levels. This is supported by two points: all loan applications were approved by the agent in Fund A³²⁰, which increased the likelihood of corrupt applications being detected; and most corruption cases in Fund

³¹⁵ Personal communication with interviewee 17

³¹⁶ Personal communication with interviewee 43

³¹⁷ Fund A and Fund B annual report

³¹⁸ Personal communication with interviewee 27

³¹⁹ Personal communication with interviewee 36

³²⁰ Personal communication with interviewee 27

B occurred in branches, leading to the executive management suspending some branches from giving loans after systemic corrupt practices were discovered and passed to the media in 2013³²¹.

From the perspective of the agent (director general) in each fund, the organisational structures might partially explain the different levels of corruption. The director general of Fund B seemed to have a lower cost of engaging in corruption than the director general of Fund A, because of the difference in levels of bargaining power which arose for two reasons: firstly, the director general of Fund B was the vice chairman of the board; and secondly, many of the board members from the private sector, including the chairman, had a financial interest (as a result of their loan applications to the fund) in maintaining a good relationship with the director general as he was the gatekeeper for all loan applications that reached the board for approval and also had the authority to delay loan repayments for many years.³²² Any rational agent in the position of director general of Fund A would feel more accountable to the board as there was no conflict of interest between the board's oversight function and their own personal business interests. This is supported by the fact that no member of the Fund A board ever had any business interests, in addition to which the director general of Fund A had never sat on the board³²³.

5.3.1.1.2 Recruitment

The second difference between Fund A and Fund B was the quality of recruitment policies and procedural manuals. Fund A had a step-by-step HR manual which determined how potential officials were selected. The manual limited agents' and sub-agents' discretion by: requiring minimum standards to be met (e.g. GPA); interviewing candidates from different department with officials from different countries (as explained previously the interview process was initially carried out by a non-Saudi national from North America); and requiring applicants to apply online, so almost 70 per cent of those who did not meet the job specifications were filtered out electronically.

³²¹ Personal communication with interviewee 45

³²² Personal communication with interviewee 37

³²³ Personal communication with interviewee 18

The Internal Audit Department was then empowered to review all recruitment activities to ensure their compliance with the HR manual³²⁴.

In contrast, Fund B's HR manual was weak and very flexible, in essence setting very low standards for fulfilling vacancies. For instance, it gave the agent the right "to directly appoint any employees without competition if they have the required qualifications for these vacancies, or they have the experience that is needed by the fund, or for low status jobs [such as gatekeeper and janitor]³²⁵." Furthermore, the minimum requirements for most jobs stated that applicants needed an "academic degree that fits the job specification."³²⁶ This ultimately seemed to encourage agents and sub-agents to abuse their positions by employing their close relatives and friends without violating these poorly designed recruitment policies and procedures. In other words, the cost of corruption was very minimal for three reasons: agent and sub-agent recruitment corruption were within the rules of the fund (weak prevention); there were no transparent recruitment process in place (weak detection); and internal auditors were not allowed to review HR activities (weak detection). In the worst case scenario, where these corrupt practices were exposed, it was hard for the board to hold the agent accountable (weak punishment) as he was the vice chairman of the board. So, the root cause of this problem, as will be discussed later, was that the principal was not fully independent of the agent; thus the agent was able to obtain the board's approval on these poorly designed HR manuals, which gave him the opportunity to hire whoever he wanted without being accountable, as the external government auditor reviewed recruitment activities in accordance with the fund's policies and procedures. Furthermore, all internal auditors worked in accordance with the agent's directions.

5.3.1.1.3 Performance-related pay

Another factor that seemed to influence the levels of corruption of both funds was performance-related pay. Fund A offered annual performance-related pay increments for its officials, based on pre-set criteria.³²⁷ In contrast, Fund B had a guaranteed fixed

³²⁴ Personal communication with interviewee 17

³²⁵ Fund's B guideline

³²⁶ Fund B's job description manual

³²⁷ Personal communication with interviewee 17

level of increment every year, with the possibility of a performance related annual bonus.³²⁸

From Fund A's perspective, corruption would be limited if officials were in full adherence with the policies and procedures, thereby linking their annual pay rise to full compliance with those policies and procedures and discouraging officials from abusing their position, as the assumption within Fund A was that corruption arose from violating Fund A's manuals for private gain.³²⁹ As a result, Fund A was able to rigidly enforce its policies and procedures. In contrast, within Fund B there were fewer short term financial incentives for being fully compliant – officials would receive a pay rise at the end of the year anyway.³³⁰ This was exacerbated by the fact that most of Fund B's policies and procedures manuals were outdated, leading to many loopholes and grey areas which could be exploited by officials for private gain without being caught. Officials in Fund B tended to rely on their memory to implement circulars from senior management that updated procedures, or simply came up with their own procedures and charts to aid them in their day-to-day work.³³¹ Indeed, this meant a higher level of discretion for Fund B officials as they did not have step-by-step manuals, like those used in Fund A.

5.3.1.1.4 Risk assessment

In theory, risk assessment increases the cost of corruption because it limits opportunities for corruption by closing loopholes in the organisation's policies and procedural manuals, which officials could abuse without being detected.

Fund A's approach to risk assessment had always been proactive and forward looking, and included brainstorming sessions to identify possible risk scenarios facing each department, before deciding how to address these risks. This contrasted with the approach taken in Fund B, where corrective action measures would be taken only when

³²⁸ Personal communication with interviewee 33

³²⁹ Personal communication with interviewee 25

³³⁰ In the longer term, not being compliant with Fund B's manuals could affect an official's chances of promotion, which occurred every three or four years. However, in order to be promoted to the most senior positions an official would require some connection or influence with the director general or member of the board.

³³¹ Personal communication with interviewee 39

corruption was discovered, and even then only to the extent of preventing a particular type of corruption from occurring again. This could include revising or restricting authority limits as well as the replacement of corrupt officials.³³² However, in Fund A reviews and modifications of internal controls were carried out with a view to preventing corruption occurring, so that if a corruption case occurred following the review and modifications, it was more likely to be discovered. To illustrate this, in Fund A, based on a risk assessment of their warehouse, internal auditors identified the risk of embezzlement before any serious cases were discovered, and recommended the installation of security cameras in the warehouse, which would prevent corruption from occurring in the first place.³³³

5.3.1.1.5 Control activities (policies and procedures)

Within Fund A's institutional setting, there were clear policies and procedural manuals that were enforced and which played a major role in reducing corruption. For instance, the credit policy guide dictates the process of each loan application to be examined by different departments, as explained in the Fund A chapter (see section 3.4.2.4). According to this, loans could not be disbursed unless they fulfilled the criteria and specifications as articulated in the credit policy guide. These specifications limited the discretion of officials by laying down, in great detail, clear procedures and examples of how each loan application should be processed, as well as determining the expectations that every official would be held accountable. For instance, Fund A's manuals specified the time limits for each stage of the loan application process, leading to fewer delays in the loans process. This ultimately reduced the potential for corruption, as all loans had to be processed within a short period of time. In cases where the time limits on any stage of the loan application process were breached, the manuals also set out who was responsible for managing the breach. These responsibilities acted as a further preventative measure against corruption, as any official attempting to slow down an application in order to receive a speed money payment would find himself under scrutiny from his superiors and internal auditors³³⁴.

³³² Personal communication with interviewee 36

³³³ Personal communication with interviewee 15

³³⁴ Personal communication with interviewee 13

In Fund B, agents and subagents behaved differently as their policies and procedural manuals were outdated. This was worsened by the fact that violating the rules for private gains did not necessarily mean that corrupt officials would be fired, or at least severely punished.³³⁵ This finding supported, to some extent, Klitgaard's corruption formula as corruption in Fund A was low because of high accountability and low discretion. However, the level of monopoly in Fund A was higher than in Fund B as all loans applications had to be approved by either the director general or the board of directors in Fund A. In Fund B on the other hand, up to certain limits, branches were authorised to process and approve loans applications without referring to head office.

5.3.1.1.6 Empowerment of internal auditors

Effective internal auditors increase the costs of corruption by detecting corrupt practices, but they were not empowered in Fund B. This could partially explain why corruption was systemic in recruitment. Within Fund A, there was a very strong focus on compliance with policies and procedures, and the level of compliance was monitored by a well-staffed and empowered Internal Audit Department. Therefore, the Internal Audit Department raised the cost of corruption by sub-agents within Fund A. This was achieved because the procedural manuals were well-written and unambiguous, so that the internal auditors could identify breaches in procedures relatively easily, thereby increasing the likelihood of detection. Also, the internal auditors were required to audit all departments periodically, including recruitment and core business. In contrast, in Fund B, the manuals were relatively poorly written, with loopholes that could be exploited by corrupt officials. This made breaches of policies harder to detect by internal auditors. What made it worse was the fact that Fund B's internal auditors were not empowered to scrutinise all departments, such as the HR Department; nor were they empowered to comment on, and improve, the policies and procedural manuals.³³⁶ All of this meant that the likelihood of being detected engaging in corruption was far lower in Fund B than in Fund A. This therefore lowered the cost of corruption in Fund B, thus

³³⁵ Personal communication with interviewee 43

³³⁶ For further discussion of internal audit empowerment in Fund A and Fund B, see section 3.5.1 and section 4.4.2.

raising the levels, as a rational sub-agent is more likely to engage in corruption if the cost is lower.

From the point of view of the agent, in both funds the Internal Audit Department made no difference to the cost of corruption. In Fund A, the internal audit charters mandated that the internal auditors reported to the director general, making them ineffective in preventing him from engaging in corruption. This ultimately increased information asymmetry between the principal (i.e. the board of directors) and the agent (i.e. the director general).³³⁷ In Fund B, the internal auditors were mandated to report to the internal audit committee, but in reality they reported to the director general, which also made them ineffective in scrutinising his actions. Furthermore, when internal auditors kept the director general informed about their audits of a regional office, he asked specifically not to be kept up to date to avoid naming and shaming any of the fund's employees, but instead he requested that they report to the auditees when they had finished their work, claiming that this would create a culture of mutual respect.³³⁸ This not only increased information asymmetry between the principal and agent, but also limited the effectiveness of the Internal Audit Department in detecting and reporting on sub-agents' corrupt practices within Fund B.

5.3.1.1.7 The role of external auditor

Unlike the internal auditing function, the appointment of an external auditor had an impact on the cost of corruption for both the agents and sub-agents in both funds. In Fund A, the board consistently appointed one of the Big Four international accountancy firms to carry out their annual external audit. These firms have an international reputation to uphold and are not so reliant on the fees from any single client that they can be put under pressure to report anything not in line with international accounting and auditing standards. This therefore makes it likely that if an agent were to engage in wide-spread or very serious corruption, it would be discovered by the external auditors. It is unlikely that such large firms could be pressurised (or bribed) to ignore such corruption as this would affect their international reputation, therefore, the cost to the

³³⁷ Personal communication with interviewee 14

³³⁸ Personal communication with interviewee 33

external auditor of ignoring obvious corruption would be high. As a result of this, the likelihood of an agent being caught by the external auditors would also be high, raising the cost of corruption. As the agent is under this scrutiny, he would therefore be under pressure to ensure that the sub-agents did not engage in corruption as this would reflect very badly on him. Therefore, the appointment of a Big Four external auditor raises the likelihood of the sub-agents being detected if engaging in corruption, which lowers the levels of corruption. This also lowers the information asymmetry between all three levels: principal, agent, and sub-agents. However, one should not overstate the importance of external auditors in detecting corrupt practices, as their auditing standards are not designed specifically to uncover corruption; rather, auditing standards oblige them to assess the fair representations of financial statements. As part of doing so, the 'Big4' accounting firms usually carry out an initial risk assessment for potential clients, and would not usually accept those with questionable institutional integrity, or would charge a higher price to carry out additional measures in order to express an opinion on the fairness of financial statements.³³⁹

In contrast, Fund B consistently appointed a local accountancy firm, which was more reliant on the fees charged, and had no international reputation to uphold. This lowered the cost of corruption to the external auditor by expressing clean opinions without conducting their audit properly in accordance with generally accepted auditing standards³⁴⁰. As a direct result of this, the agent and sub-agents were under less pressure to run a clean institution as they could (and did) restrict the evidence external auditors were able to obtain which was necessary to support their opinions. Therefore, the external auditor had to strike a balance between losing an important client and the consequences of expressing a clean opinion on inaccurate financial statements.³⁴¹ This lowered the cost of corruption as detection became less likely, thus giving the agent and sub-agents the opportunity to engage in corruption, and if they were rational (and this theory assumes that all parties act rationally), they would be more likely to do so.

³³⁹ Personal communication with interviewee 22

³⁴⁰ In accounting, external auditors have four types of opinion on the fairness of financial statements: clean opinion (sometimes called unqualified opinion), qualified opinion, adverse opinion, and disclaimer opinion.

³⁴¹ Personal communication with interviewee 8

5.3.1.2 Main features of agency theory

The hypotheses that relate to agency theory are as follows:

H2: an effective internal control leads to a lower perceived level of corruption when there is an active principal

H3: an effective internal control leads to a lower perceived level of corruption when there is a clean principal

H4: an effective internal control leads to a lower perceived level of corruption when there is a powerful and independent principal

Table 5.1 summarises the most important evidence that this thesis presents to support these hypotheses.

Table 5.1

Examining internal factors in the principal-agent model

| Agency pillars | Fund A | | Fund B | |
|------------------------------------|-----------------------------------|---|-----------------------------------|---|
| | Importance in reducing corruption | Evidence | Importance in reducing corruption | Evidence |
| Active principal | Medium to High | <ol style="list-style-type: none"> 1. One of the ‘Big4’ accounting firms was consistently employed as an external auditor 2. State of the art policies and procedural manuals were approved 3. Intensive training programmes were provided for almost all officials with a total training budget of USD 22,352,000 in 2015. 4. Internal Audit Department was established more than 30 years ago, and since then it has been consistently empowered by the board with sufficient staff, and incentives for those staff to take internationally recognised professional certificates. Thus half of them have CIA or CPA. 5. Although internal auditors were empowered by the board, internal audit reports went to the board through the agent (director general), but the agent never edited the internal audit report. | Low | <ol style="list-style-type: none"> 1. A local accounting firm was consistently employed as an external auditor 2. Inadequate and outdated policies and procedural manuals were approved and maintained 3. Weak training programmes with a training budget of only USD 2,237,923 as of 2015. 4. Internal Audit Department was recently established by the board in 2013. However, at the time of the research, no officials in the department had professional audit qualifications, i.e. Certified Internal Auditor (CIA) or Certified Public Accountant (CPA). 5. Internal audit reports were modified by the agent (the director general) who was a member of the audit committee. |
| Clean principal | High | <ol style="list-style-type: none"> 1. Agents were consistently recruited with strong integrity credentials 2. All board members were senior government officials who had no business interest in the fund | Low | <ol style="list-style-type: none"> 1. Some board members had financial interests as they were businessmen and had outstanding loan applications 2. Some board members recruited their relatives to the fund |
| Powerful and independent principal | High | The board was totally independent from the agent, and therefore in theory it was in a better position to monitor and hold the agent accountable to its policies and procedures. | Low | The board was not independent from the agent as the agent (director general) was the vice chairman of the board. |

The fact that Fund A had better institutional incentives (i.e. hard control) than Fund B could explain the different levels of corruption in both funds from agency theory perspective. However, this does not tell the whole story as it was clear from the analysis of both cases that what the rational-choice institutionalists would call “corruption equilibrium” (i.e. others’ behaviour as an incentive) also matters in determining levels of corruption.

5.3.2 Rational Choice Neo-institutionalism Explanation

As explained in section (1.2.2), rational choice neo-institutionalism also makes the assumption that actors are always rational and carry out a cost-benefit analysis prior to making a decision – such as whether or not to engage in corrupt practices. However, the theory also suggests that individuals in a large or small group must work together to attain the group’s objectives. Thus rational choice neo-institutionalism introduces the concept of a corruption equilibrium within an institution to explain how the level of corruption within two broadly comparable and similar institutions such as Fund A and Fund B can have such different levels of corruption. A rational choice scholar would say that in Fund A, the corruption equilibrium is lower, and so a rational actor may consider the costs of corruption within the context of their institutional setting. That setting would in turn shape the range of outcomes and the rational actor would opt for the outcome that suits him or her best (which is more likely to mean not engaging in corrupt practices), hence there is a lower level of corruption, whereas in Fund B the equilibrium is higher, so a rational actor will carry out the same analysis based on the context of their institutional setting, and is more likely to engage in corrupt practices than if he were employed by Fund A, hence the level of corruption is higher.

The following section discusses internal control practices that might have impacted the levels of corruption in both funds from the lens of rational choice neo-institutionalism. The focus will be on the following factors:

5.3.2.1 Soft control anti-corruption strategies

5.3.2.1.1 *Tone at the top*

When assessing the tone at the top, it is safe to say that this sets what can be called ‘*the rules of the game*’ for each government institution, and these shape the likelihood of officials engaging in corrupt practices. If the rules of the game allow the players to act corruptly, then they are more likely to do so than if the rules of the game are designed to prevent, detect and punish this. This could be seen in a number of examples discussed in the preceding chapters. The first and most obvious example is related to work attendance in both funds. In Fund B, a weak work attendance policy was clearly seen to be implemented at all levels, starting from the director general through to front desk employees.³⁴² In comparison, all Fund A’s officials showed a high level of commitment to work attendance.³⁴³ Although attendance does not represent an absolute measurement of institutional integrity, it could be used as an indicator for actors’ overall commitment to policies and procedures manuals, assuming that corruption arises mostly from violating the rules for private gains.

The main lessons for discussing the level of compliance regarding attendance is that the signals received from the top management in both funds affected the culture of the organisation throughout. If the policies regarding attendance at work and prompt arrival at work were ignored by senior managers, as in Fund B’s case, then they were more likely to be ignored by staff. If staff then got the message that some policies were not complied with by senior management, they might have formed the opinion that all policies were equally flexible in interpretation, in which case staff might then have decided that policies regarding anti-corruption were also flexible and could be ignored, assuming the organisation had anti-corruption policies at all. This was one way in which corrupt practices could spread throughout an organisation – by the messages from the top that policies were not to be rigidly enforced.

With the help of rational choice neo-institutionalism, officials’ behaviour towards work attendance policy in both funds was understandable and to be predicted. Actors in Fund A seemed to adhere to this policy because all actors at different levels of hierarchy

³⁴² Personal observation and personal communication with interviewee 51

³⁴³ Personal communication with interviewee 22

abide by the rules. Therefore, any actor who violated this policy would be immediately identified by the hard control anti-corruption measure, in this case a fingerprint confirmation of attendance system then, based on historical senior management attitude towards non-compliance cases, this actor would be more likely to be punished.³⁴⁴ Therefore, rational actors were expected to abide by the fund's business hours. However, if the same actor were employed in Fund B, his behaviour would be expected to be different, taking into consideration the following factors: the vast majority of all actors in Fund B, including the senior management, consistently came to work at least one hour late (negative tone at the top); no one had ever been punished for not abiding by the attendance policy³⁴⁵ (weak accountability); no effective monitoring tool for work attendance (weak hard control); and internal auditors are not empowered to enforce this policy (weak monitoring control); In fact, internal auditors themselves seemed to have some issues with their attendance. All of these factors facilitated the growth of corruption in Fund B, where hard controls would, to some extent, have been ineffective in preventing corruption.³⁴⁶

It is interesting to note how quickly new employees adopted the culture in both funds. Newly recruited employees seemed to begin their careers in the two funds with enthusiasm and fully intending to abide by the rules; however, shortly after their appointment, they adapted to the organisational norms and culture. For instance, in Fund A they would commit themselves to the fund's policies and procedures manuals, including attendance policy, knowing that they would be likely to be under the direct supervision of competent, trustworthy superiors as well as undergoing continuous audit, and that they would be held accountable based on these manuals.³⁴⁷ In addition, the majority of newly recruited officials, who were interviewed in Fund A seemed to agree that their career path was more likely to be outside the fund.³⁴⁸ Their intention in joining the fund was to gain both training and experience in a highly professional environment to secure lucrative positions in the private sector. This may have contributed to lower levels of corruption in the fund as a result of the newly recruited officials' intentions to protect their integrity in order to get a good reference from the fund, as well as high

³⁴⁴ Personal communication with interviewee 22

³⁴⁵ While being late or leaving early for one hour or so seemed to be acceptable, being absent for a full day, without proper permission or submitting a vacation request, was punishable in Fund B.

³⁴⁶ Personal communication with interviewee 33

³⁴⁷ For further discussion of institutional integrity of both funds, refer to sections (3.3.1) and (4.2.1).

³⁴⁸ Personal communication with interviewee 20

turnover in the fund which distracted officials from having long term relationships with the fund's clients.³⁴⁹ The inability to establish a long term relationship is more likely to lead to a lower level of corruption because many corrupt practices arise out of trust between the corruptor and corruptee (Rose-Ackerman, 1999; Rose-Ackerman & Palifka, 2016).

5.3.2.1.2 Organisational structures

Another difference in the soft control between Fund A and Fund B was in organisational structure. Fund A only had one office based in Riyadh where all its officials worked, whereas Fund B had a much more decentralised structure with regional branches and offices across the country.³⁵⁰ These differences in the organisational structures may have impacted on the organisations' norms and culture, leading to higher or lower levels of corruption. For instance, the tone at the top, which is a key factor in determining the level of institutional integrity, spread more easily in Fund A, whereas in Fund B which had offices all over the Kingdom of Saudi Arabia, the message from the top in terms of examples set by the executive management team would not necessarily reach officials working many hundreds of miles away.

The key implication of this decentralised structure in Fund B is that the regional branches effectively had to set their own organisational norms through branch management. Therefore, the organisational culture in each branch would inevitably differ between branches and be dependent on the ability and desire of the branch management to set the best example. This was evidenced by the differing levels of corruption discovered at individual branches. For instance, some branches had to be suspended because of the endemic corruption found to be taking place. Also, the executive management were aware that some branches were particularly susceptible to tribal and family influence. These branches were monitored more closely by head office in terms of empowering internal auditors to carry out more intrusive checks on these

³⁴⁹ Personal communication with interviewee 20

³⁵⁰ Personal communication with interviewees 17 and 43

branches, and having a more rigid enforcement of policies and procedures than other branches where threat of undue tribal influence was perceived to be lower.³⁵¹

5.3.2.1.3 Board independence

The third major difference between the funds' soft control was the level of board independence. In Fund B some board members, including the chairman of the board, were from the private sector, which seemed to improve the performance of the fund as they were in a better position to assess its needs using their experience from commerce and industry.³⁵² In contrast, Fund A did not have any representatives from the private sector on the board.³⁵³

In Fund B, the private sector board members played a dual role as they also held senior positions in, or were owners of, firms who were clients of the fund at the same time as overseeing the running of the fund. This created a potential corruption opportunity as managers working in the fund would have had their work scrutinised by the board who were also applicants for loans from the fund. This made it harder for managers to be completely objective as they were analysing loan applications from clients who had representatives on the board.³⁵⁴ In addition to this, staff who worked in Fund B who were looking to be promoted to senior positions within the fund had their application decided upon by board members, some of whom were clients of the fund. This was another opportunity for loans to be approved without necessarily being assessed objectively as staff members might have been concerned about having their promotion chances affected³⁵⁵. Consequently, this organisational context meant that the director general, as a rational actor, could not be objective when deciding whether or not to approve loans from the board members' companies as his position relied on their support. In fact, this created a win-win situation in which the director general would approve loans to board members' firms and as a result the board (also acting rationally) would be more likely to extend his contract every four years.³⁵⁶ This conflict of interest

³⁵¹ Personal communication with interviewee 45

³⁵² Personal communication with interviewee 34

³⁵³ Fund A annual report

³⁵⁴ Personal communication with interviewee 39

³⁵⁵ Personal communication with interviewee 42

³⁵⁶ E.g. personal communication with interviewees 33, 37, and 42

had been the case in Fund B for a long time, and in one instance the chairman of the board decided to step down when the issue was raised by another member of the board. Consequently, such conflict of interest was rooted in the history of Fund B, creating an organisational culture that encouraged actors to act in their own self-interests, and engage in corrupt practices when the benefits of corruption were higher than the cost of doing so.³⁵⁷

What matters here is not whether the board members or the director general were actually abusing their positions for private gain, but that many officials within Fund B perceived there to be manipulation or relaxation of the rules by the board and the director general to serve their own interests. This perception affected the whole culture of the organisation as it encouraged all officials to rationalise unethical behaviour if it benefited the officials concerned. What stopped them was when the balance of getting caught and punished outweighed the likelihood of getting away with corrupt behaviour. This could be seen in many officials justifying running their own businesses when they should have been working at the fund by stating that board members were also acting in the interests of their own businesses when they should have been acting in the interests of the fund as a whole.³⁵⁸ This could also be seen in Fund B's regional offices (where corrupt practices tended to be higher than in the head office) as officials appeared to rationalise the approval of loans that should not have taken place to family or tribal members on the basis that the board were approving loans that benefitted their own private interests rather than applying the same rules that they would to other loan applications.³⁵⁹

In Fund A, none of the board members were appointed from the private sector – they were all senior government officials. Therefore, this dual-role conflict of interest did not exist, leading to the implications that: firstly, none of the management felt obliged to approve loans on anything other than an objective basis – i.e. they met the criteria of the credit policy guide; and secondly, the cost of corruption for board members who engaged in corrupt practices by influencing the executive management's decisions or recommendations on loan applications or recruitment would have been higher than for board members from the private sector as they ran the risk of being fired from both the

³⁵⁷ Personal communication with interviewee 53

³⁵⁸ Personal communication with interviewee 42

³⁵⁹ Personal communication with interviewee 36

board of directors and their senior government position. A board member who owned his own company, however, would simply continue to run and/or own his firm.³⁶⁰

5.3.2.1.4 Training

Another factor that might have shaped the institutional integrity in the funds was training. Fund A provided an intensive training programme in English language and in accountancy and finance, which they insisted on all new recruits taking; the accountancy and finance training was also all in English. All new recruits had to pass this intensive training prior to being offered a permanent position within Fund A. The level of competency required in English was high, demanding a TOEFL score of 450 (or equivalent) in order to even be accepted onto the training programme.³⁶¹

Fund B had no such programme, and much of their recruitment was based on nepotism or other internal contacts. However, in order to increase the levels of competence within the organisation, Fund B asked Fund A if they could send their staff on Fund A's training programme. This was accepted by Fund A; therefore, Fund B tried to find employees willing to attend the programme. However, only one employee from Fund B volunteered to attend the training programme, and he was eventually unsuccessful in his attempts to pass. The other employees refused to go on the course as they had no incentive to attend: attendance would have meant that they could not work any overtime (which made up approximately 50 per cent of their income);³⁶² the culture within Fund B was that employees were not appreciated for being well-trained and educated;³⁶³ also many employees were concerned that they would fail the tough training programme.³⁶⁴

The first point to be made from this was that the evidence from Fund B showed that there did not appear to be any financial incentive to undertake training programmes or attain professional certificates, nor were there any deterrents for not doing so, such as not receiving a permanent employment contract or achieving promotion to a higher position. For instance, within Fund A officials required a globally recognised

³⁶⁰ For a further discussion of board independence in both funds, see section 3.3.5 and 4.2.5.

³⁶¹ Personal communication with interviewee 17

³⁶² Personal communication with interviewee 50

³⁶³ Personal communication with interviewee 37

³⁶⁴ Personal communication with interviewee 50

professional certification in auditing to be promoted to Grade 23 in the Internal Audit Department.³⁶⁵

Clearly, the training programme was one of the main distinctions between the two funds. While training was very weak in Fund B, Fund A's training programme was well-established, having existed for over 30 years. In 2014, Fund A invested USD 22 million in employee training – a much greater sum than Fund B.³⁶⁶ Fund B's training budget for 2014 was USD 5.3 million of which only USD 2.4 million was actually spent.³⁶⁷ The average amount budgeted for training each official in Fund B was approximately USD 2,600, and the average amount budgeted for training each official in Fund A was approximately USD 23,000.

In Fund A, the training programme involved a placement at a bank in North America, which helped to develop a culture in which corruption was considered unacceptable. Also, because the training programme was highly sought after the levels of staff satisfaction on the programme were very high, and so employees were less likely to jeopardise their positions on the programme by acting corruptly. Almost all respondents felt that Fund A's training programme played a role in maintaining low levels of corruption within the fund. By having the programme, Fund A was able to attract superior applicants within the market; in fact, some applicants accepted a pay cut to take a position at the fund as the training would, in the long term, lead to greater rewards.³⁶⁸ For example, one employee was earning USD 3,000 per month at a local bank, and accepted a position at Fund A on USD 2,500 per month because he expected that after completing the training programme and working at Fund A for two or three years, he would be worth USD 6,000 per month in the banking industry;³⁶⁹ therefore Fund A could select the candidates who were more competent with higher qualifications and least likely to be corrupt. By providing this programme, Fund A improved their employees' conduct and ability to engage with professionals from the West, who were less likely to be involved in corrupt practices. This then became a cultural norm within Fund A, as all employees had to attend the training programme and there was little chance of being appointed to a senior management position without

³⁶⁵ Personal communication with interviewee 12

³⁶⁶ Email from interviewee 57

³⁶⁷ Personal communication with interviewee 33

³⁶⁸ Personal communication with interviewee 16

³⁶⁹ Personal communication with interviewee 16

successfully completing the programme. Also, being highly trained opened up opportunities to work in the private sector in lucrative positions. Fund A's training programme was highly regarded and the sector was fairly small – therefore anyone being fired for corrupt practices would be known within the industry and would ruin their reputation and any chance of a lucrative private sector position.³⁷⁰

5.3.2.2 Hard control anti-corruption strategies

There is a link between soft and hard controls as soft control represented the organisational environment in which hard control anti-corruption mechanisms operated in both funds.

5.3.2.2.1 Risk assessment

The approach to risk assessments in the respective funds appeared to have been influenced by soft control. For a start, all actors in Fund A appeared to have been recruited on merit, before going through intensive training programmes inside and outside Saudi Arabia. These training programmes were a continuous process for all actors on all levels in Fund A. In addition, the skills of Fund A's officials were strengthened by working shoulder to shoulder with Western experts who were more knowledgeable about best international practices. All these soft control factors shaped management thinking, to be more proactive in tackling different issues, including corruption.³⁷¹ On the other hand, Fund B's appointment of less competent officials and the lack of proper training or exposure to the Western world's business culture limited the management's ability to implement advanced management tools such as risk assessment. This ultimately led to more corruption cases in Fund B as corruption risks were not identified before they occurred.³⁷²

³⁷⁰ Personal communication with interviewee 20

³⁷¹ Personal communication with interviewee 12

³⁷² Personal communication with interviewee 36

5.3.2.2.2 *Control activities*

The approach to control activities in the respective funds also appeared to have been influenced by soft control. Having highly competent and trained officials coupled with a culture of accountability incentivised actors in Fund A to keep all manuals updated and enforced. Within the fund's institutional setting, it was virtually impossible for any official, including the director general, to violate those manuals for private gains as it became the norm that everyone abided by them because they would be held accountable to them. For instance, if the director general or a senior manager of Fund A intended to approve a loan application for a friend, he could not do so without requesting his friend to submit his loan application to the customer service team, which would then be processed according to the correct procedures. Those procedures could not be bypassed as they were set by the credit policy guide, which was approved by the board.³⁷³

In Fund B, actors behaved differently as they had weaker skills and knowledge to develop the fund's manuals as effectively. Therefore, the general attitude of any rational actor in Fund B was that it was pointless developing strong hard control as in Fund A while the level of enforcement and commitments were different. In other words, why would rational actors in Fund B work hard to produce a procedural guide that eliminated as many ambiguities as possible if there was slack enforcement of the procedures by senior manager and/or internal audit? The key point here is that expectations are important and set by organisational context. Creating high quality manuals where there is no will from the top to enforce them would appear to be a pointless exercise. Therefore, a rational actor would not even attempt to do so because they would be aware that they would receive no support from their colleagues or managers.³⁷⁴

In short, the extent to which internal control is effective in tackling corruption depends on how those controls are initiated and enforced. Fund A showed that establishing an institution with a culture which implies that ethical behaviour is the norm increases the likelihood that hard and monitoring anti-corruption controls will be effective, thereby helping to reduce corruption levels. On the other hand, Fund B showed that if the culture of the organisation appears to tolerate corruption – for example, by allowing the recruitment process to be tainted by nepotism – then hard control and monitoring

³⁷³ Fund's A credit policy guide and personal communication with interviewee 13

³⁷⁴ Further discussion of how weak Fund B accountability is presented in section (4.2.9)

mechanisms are unlikely to be as effective, leading to higher levels of corruption than in an organisation in which such practices are considered less acceptable.

5.3.2.3 Monitoring anti-corruption strategies

There is a link between soft and monitoring controls as soft control represented the organisational environment in which monitoring control anti-corruption mechanisms operated in both funds. In Fund A the vast majority of officials seemed to be in compliance with the fund's manuals because they knew that they would be under audit at some point in time.³⁷⁵ Such expectation by itself limited corruption as officials feared violating the rules for private gains and then being detected and held accountable. On the other hand, Fund B's officials felt more confident or safer in committing corruption as they were sure that internal auditors were limited to examining certain activities in the fund, i.e. accounting function in the head office and the fund's branches, so corruption was high in recruitment which internal auditors were not authorised to review. Also, there were some corruption cases in the fund's branches because internal auditors' findings were not taken seriously by the senior management to the extent that the director general asked the internal auditors not to copy him in with their audit findings.³⁷⁶ However, internal auditors seemed to help to keep corruption very low in the vast majority of the fund's branches.

5.3.2.4 Main features of rational choice neo-institutionalism

Figure (5.1) illustrates how internal control influenced the levels of corruption of both funds assuming that: there were more corrupt officials in Fund B than Fund A, which is based on the number of corruption cases in each fund, and the Saudi Corruption Index as discussed in the previous two chapters; fixed demand as everyone wants to get access to this government fund; and the supply of corruption being influenced by the

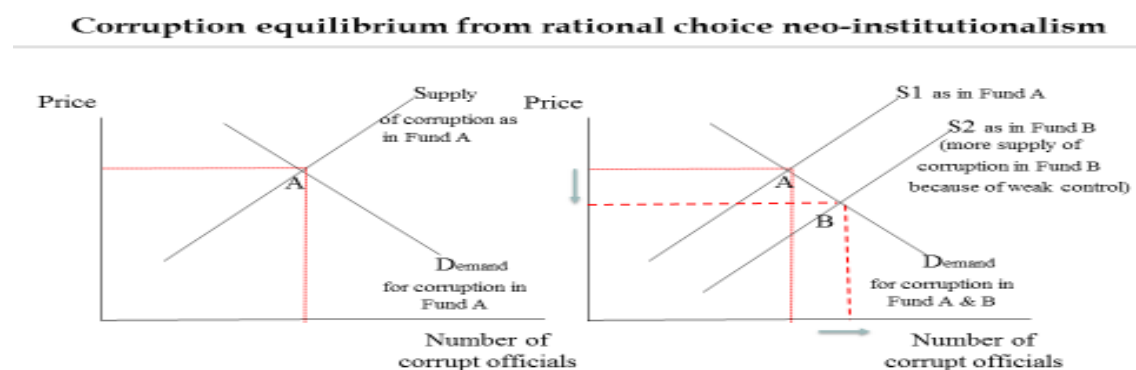
³⁷⁵ For further discussion, see section (3.5.1.2)

³⁷⁶ For further discussion, refer to section (4.4.2)

effectiveness of internal control, i.e. the more effective internal control, the lower the number of corrupt officials.

Figure 5.1

Corruption equilibrium in both funds



Based on the analysis shown in figure (5.1), it is clear that the costs and benefits of corruption in government organisations are determined by the corruption equilibrium or the extent of corruption.

This was seen in Fund A where the low levels of corruption itself increased the cost of corruption *not only* because the fund's officials trusted and perceived that their colleagues would not engage in corruption – a point emphasised by many collective action scholars – but also because corrupt officials would find it hard to indulge in corruption without being detected, prevented, and punished. Corrupt officials were prevented due to Fund A's rigid checks and balances, which were such that every loan application had to be approved by different officials from different departments within the fund. So in order to bypass these rigid checks and balances, corrupt officials would have to corrupt (or collude with) other officials (to overlook corrupt decisions) within other departments. This was unlikely to occur when taking into consideration the

institutional integrity of the fund. Assuming that corrupt officials were able to override the checks and balances, there would be a high probability of being detected by the Internal Audit Department, as internal auditors were empowered and highly trained to uncover non-compliance cases.

By default, *the increased costs of corruption in Fund A would lead to higher benefits of being corrupt* as corrupt applicants would find a very limited number of officials who would be willing to risk their future in exchange for corrupt decisions.

The same analysis could be applied to Fund B to show why corruption equilibrium is higher than in Fund A.

Based on the analysis of both funds, one could argue that an organisation with high levels of corruption will, assuming nothing drastic changes, always have high levels of corruption, as the operation of anti-corruption mechanisms depends on the corruption equilibrium within both funds. Therefore, one finding of this research is that as the number of officials who are acting honestly increases, the likelihood of anti-corruption mechanisms working increases and vice versa. This supports the following hypothesis:

H5: An effective internal control leads to a lower perceived level of corruption when the corruption equilibrium is low.

However, this theory provides little explanation of how the institutions attained their different levels of corruption in the first place, with Fund B employing a large number of corrupt officials, and Fund A successfully keeping the number of corrupt officials employed in the fund to such low levels. Essentially it still makes the assumption that history does not matter, although it does at least acknowledge that the equilibrium of an organisation can change, slowly, as actors respond differently to changes in the costs of engaging in corruption and the benefits of acting honestly and with integrity. However, it is the historical context of an institution that provides the base of the third theory of corruption – historical institutionalism.

5.3.3 Historical Institutionalism Explanation

Historical institutionalism has as its fundamental feature the idea of path dependency. As discussed in section (1.3), this theory states that once an organisation is set on a path towards a particular level of corruption, it invariably stays on that path. Essentially, and in contrast with the other two theories, it states that history matters. What this approach means to policymakers is that a “top down” approach to internal controls that only focuses on hard and monitoring controls is unlikely to be successful in creating an organisation that maintains a low level of corruption. Here the focus is not just on hard and monitoring controls, but also on the soft controls - how an organisation needs to be *set up* with a clean, active board of directors who set the right tone at the top from *day one*.

5.3.3.1 Soft control anti-corruption strategies

The soft control set at the establishment of both funds provided the most obvious difference between the respective funds’ attitudes to anti-corruption mechanisms. Clearly, within Fund A’s context the tone at the top, board independence, recruitment, training and accountability were set appropriately at *the establishment of the fund*, and continued to exist until the time this research was conducted. In contrast, all these features did not seem to be set appropriately in Fund B, which could largely explain its relatively high levels of corruption when compared to Fund A.

5.3.3.1.1 Tone at the top

Starting with the tone at the top within Fund A, Western experts seemed to have demonstrated high ethical standards to the Saudis appointed to work at the fund at its establishment, thereby establishing these norms and values within the organisation which appeared to have been maintained for many years and were still present at the time of this research. In fact, many key functions in Fund A are still handled by Western experts. This shows that the soft control environment in the fund was shaped by a Western bank, and that the norms and values of the officials from this bank were

transferred over to the fund's officials by a number of means: by demonstrating an absolute commitment to integrity and setting the right tone at the top; by establishing the right structure and clearly defining and limiting authorities and responsibilities, and then holding individuals accountable for these; and by attracting and developing competent individuals to run the fund in a similar manner to the Western bank. This included an intensive in-house training programme and secondments to absorb the culture, the practices, and the work philosophy of Western institutions to carry back to Saudi Arabia. This proved most effective as it applied to almost all officials within the fund.³⁷⁷

In contrast, Fund B was less successful in tackling corruption because they lacked the organisation culture that incentivised and rewarded actors within the organisation to operate hard control anti-corruption mechanisms. Therefore, officials were more likely to abuse their positions when hard controls were weak, opening the door for them to engage in corruption when the opportunity was presented to them. For instance, the experts from a country perceived to have consistently high levels of institutionalised corruption (according to Transparency International's index) who helped *to set up* Fund B, seemed to lack commitment to high ethical standards. This can be evidenced by a number of these experts who were discovered to be corrupt and were subsequently fired from the fund after working there for many years. These experts also failed to show a commitment to competence and high training standards, and the policies and procedures that they developed and implemented lacked the rigid separation of powers and responsibilities, and contained many loopholes that could be (and were) exploited by officials working within the fund for many years afterwards.³⁷⁸

Also within Fund B, the approach to reducing corruption was reactive rather than proactive. The assessment of any loopholes in their policies and procedures would be to attempt to close them after they had been exploited for corrupt purposes. This contrasted with Fund A's approach whereby they would seek out potential loopholes and close them before they could be exploited. Indeed, Fund A was considered to be

³⁷⁷ Personal communication with interviewees 11 and 16

³⁷⁸ Personal communication with interviewee 33

among the first Saudi organisations to introduce an internal audit function more than 30 years ago, when the fund was established with help from the Western bank.³⁷⁹

However, these norms and values within Fund B appeared to have changed significantly following a restructuring in 2010. These changes introduced a new salary scale that increased salaries across the board, and established the Internal Audit Department. This led to a significant reduction in the level of corruption in the core business as the cost of corruption increased due to a greater likelihood of being caught, fired and the loss of a significantly higher salary. However, this change led to an increase in corruption in the support functions – most obviously in the recruitment process – as the fund was given a greater level of independence from central government, and the senior management prevented the Internal Audit Department from reviewing recruitment activities.³⁸⁰

5.3.3.1.2 Recruitment

Another factor that might explain the different levels of corruption in the two funds was recruitment. Within Fund A, the recruitment process appeared to be almost incorruptible, with highly competent officials appointed on merit.³⁸¹ This contrasted with Fund B where a number of tactics were adopted to circumvent the HR recruitment policies. One method was to hire family or tribal members on a temporary contract. Temporary contracts were not subject to the same rigid scrutiny as permanent contracts, and so it was easier for HR to hire family members in this way; however, after about a year, HR would decide that these positions now needed to be made permanent. Another method, which was widely used between 2010 and 2015, was to advertise posts; then HR would filter out many of the candidates who applied for these roles on spurious grounds – such as eliminating anyone who had a permanent employment position on the grounds that the applicants needed to be immediately available. Then, there appeared to be collusion at the interview stage, whereby other external candidates would be eliminated, leaving HR to appoint the family members of senior management or members of the board of directors on a permanent basis. The root cause of this

³⁷⁹ Personal communication with interviewee 36

³⁸⁰ Personal communication with interviewee 33

³⁸¹ Personal communication with interviewee 20

problem seemed to be soft control as the senior management and some board members were aware of this issue and kept silent about it. In fact, they appeared to be the main beneficiaries of it. One interviewee said, “All you need to see is the last names of newly recruited individuals and match them with senior management’s surnames.”³⁸² Another interviewee confirmed this finding and also suggested comparing the newly recruited individuals’ surnames with the board members’ surnames.³⁸³

What should also be noted about recruitment to Fund B is the change that has occurred since 2009. When Fund B was established, it adopted the same salary scale as other government ministries. This meant that the salaries paid were low, but that the Ministry of the Civil Service, rather than Fund B itself, carried out recruitment. Therefore, prior to 2009 the recruitment process appeared to be clean, but there seemed to be far more corruption in the core business – largely as a result of the low salaries and organisational culture of accountability at that time, which reduced the cost of being caught and fired for engaging in corruption.³⁸⁴

In 2010, Fund B became an independent agency and so became free to adopt its own salary scale, and to fire its own staff if they were caught acting corruptly. Fund B therefore adopted a salary scale similar to the one used at Fund A, which had always been different from other government ministries. This increased the salaries that Fund B paid which increased its attractiveness as an employer. It also allowed Fund B to recruit its own staff independently of the Ministry of the Civil Service, and meant that HR could start to employ friends and relatives, rather than appointing purely on merit. The thinking among senior management appeared to be that their long service at Fund B entitled them to employ their sons and other close relatives to work in the fund. However, as discussed above, the higher salary, and management’s freedom to fire their own staff, increased the cost of corruption. This, therefore, seemed to reduce the levels of corruption within the core business, which meant a complete reversal of Fund B’s position, from having a clean HR process but higher levels of corruption in the core business in 2009 to having a corrupt recruitment process but low levels of corruption in the core business, which seems to have been the case between 2010 and 2015.³⁸⁵

³⁸² Personal communication with interviewee 37

³⁸³ Personal communication with interviewee 33

³⁸⁴ This paragraph and subsequent paragraph are based on personal communication with interviewee 33

³⁸⁵ Personal communication with interviewees 37 and 42

5.3.3.2 Hard control anti-corruption strategies

Undoubtedly historical background played a major role in shaping and developing hard internal control practices in the case studies examined. In both funds, path dependency seemed to shape the three areas of hard control as outlined in the COSO Framework: how risk assessments were carried out, how control activities were developed, and the way information and communication were utilised.

5.3.3.2.1 Risk assessment

The historical background appeared to affect the funds' approaches to anti-corruption risk assessments in the following ways. Fund A's approach to risk assessment was established a relatively long time ago, which contrasts greatly with the approach in Fund B where there appeared to be very little knowledge of how to implement a risk assessment process in their business. These differences in approach could be linked to the ways each fund was set up.³⁸⁶

Fund B's set up process was handled by experts from a developing country. These experts were hired as employees of the fund – unlike the experts who set up Fund A, who were on secondment from the Western bank. Therefore, the worst case scenario for the experts who set up Fund B was being fired from the fund, whereas for the experts who set up Fund A, the worst case scenario was being fired from the Western bank, plus being imprisoned by their own country's authorities for corruption.³⁸⁷ This meant the cost of corruption from the very start was higher in Fund A than Fund B. This provides the historical background to the greatly differing approaches to anti-corruption risk assessments within the respective funds.

³⁸⁶ Personal communication with interviewee 46

³⁸⁷ Personal communication with interviewees 16 and 51

5.3.3.2.2 Control activities

The historical background in the respective funds also shaped the development of each fund's respective control activities in ways that can be compared and contrasted with one another. This can be most clearly seen in the establishment and development of both funds' procedural manuals that form the basis of the way that each fund is run.

Fund A's manuals were established over thirty years ago, and were effectively copied from those used by the Western bank, with some modifications to reflect the fact that the fund was a non-profit-making governmental organisation rather than a commercial bank. This was clear from the fact that the manuals were written in English and had still not been wholly translated into Arabic at the time the research was conducted.³⁸⁸³⁸⁹

Having these well written manuals contributed to Fund A's low level of corruption as they clearly outlined each process within Fund A, determining the responsibility of each official in terms of how to process loan applications in a timely manner. This indeed limited officials' discretions because they could not reject or delay loan applications without proper reasons based on specific articles in the fund's manuals.³⁹⁰

Fund B's manuals were, by contrast, written from scratch by the officials from a similar organisation to Fund B based in a less developed country. These manuals were not robust enough in closing loopholes that could be exploited by both corrupt official and corrupt applicants. For example, in Fund B, the manual setting out the terms and conditions of the loans did not impose any time limits on how soon after the loan was disbursed the project for which it had been granted had to be started. This led to the initial loan disbursements being held by some applicants for many years without any work on the project taking place. Another loophole in the manuals was the requirement to employ middlemen (external consultants) to prepare feasibility studies for potential applicants even though the vast majority of these feasibility studies were almost identical as consultants used the same information in each study, only changing the personal details for each potential applicant.³⁹¹ These poorer quality manuals therefore

³⁸⁸ Only the letters and forms that were to be seen and read by applicants to the fund were translated into Arabic.

³⁸⁹ Personal communication with interviewee 22

³⁹⁰ Personal communication with interviewee 13

³⁹¹ Personal communication with interviewee 38

set the historical precedent whereby the opportunities for corruption were present and more easily accessible than in Fund B (thus increasing the benefits of engaging in corrupt practices), and the control mechanisms that might have led to corrupt practices being discovered were less effective than in Fund A (thereby reducing the costs of engaging in corrupt practices). The result of this would therefore be lower levels of corruption in Fund A than in Fund B.

5.3.3.2.3 Information and communication

Path dependency also shaped how information was communicated inside and outside the two funds. Fund A followed the tradition of the Western bank where confidentiality was essential for their business. Surprisingly, since its establishment Fund A officials had always kept the same level of confidentiality as in the Western bank, whereby all documents and records were considered to be confidential, even within the fund itself where there was no document sharing. All HR policies were confidential, as were decisions made regarding promotions, etc. All policy and procedure guides were also confidential, including the credit policy guide. Only staff working in the Credit Department had access to this document and even they were not provided with a printed copy of it.³⁹² If anyone wanted to print off all or part of the guide, they could do so, but this was noted and a record was kept.³⁹³ This low level of transparency seemed to undermine some of the good aspects of Fund A's manuals. For instance, one strength was to encourage potential applicants to deal directly with the fund, i.e. without the need for consultants (middlemen) to prepare the feasibility studies. However, since the fund placed restrictions on document sharing, former Fund A officials had a competitive advantage in marketing themselves as consultants to the private sector to those firms who wanted to apply for loans to the fund. As they had greater knowledge of the loan application process than those who had never seen the credit policy guide, they could provide an advantage to those firms willing to pay fees to make their loan applications more likely to succeed and obtain the most benefits (maximum loan limits) from the fund. A more transparent document-sharing culture would be likely to reduce

³⁹² Only team leaders and managers had a printed copy of the credit policy guide.

³⁹³ This was one of the obstacle of this research as Fund A had rigid restrictions over getting access to its manuals.

the chance of this happening. The senior management of Fund A was aware of this issue. They sent letters to all consultants warning them about linking their fees to the success of their clients' applications. Furthermore, the limits on transparency were to some extent mitigated by the increasing amount of information published on Fund A's website, in both Arabic and English, which could obviously be accessed by both staff and potential clients.³⁹⁴

In Fund B, there was more transparency with regard to policies and procedures. There was a greater willingness to share copies of policy and procedure guides.³⁹⁵ However, they had far fewer policy guides documented and these were not updated on a regular basis. Changes to policies occurred with the issuing of circulars, but there was no periodic review to update the official documents with the changes that had been made to them. This made the task of auditing compliance far more difficult.³⁹⁶

Looking only at one aspect of Fund A with regard to low level of transparency, the corruption literature would suggest that corruption should be higher in Fund A, but the reality was quite the opposite. The consequences of having one weak element of internal control (low transparency) in Fund A was alleviated by other internal control mechanisms. To illustrate this, Fund A had opaque HR policies, which could be seen to increase the levels of dissatisfaction within its staff as they were unaware of what they had to do to attain promotion or a pay rise.³⁹⁷ High levels of staff dissatisfaction could sometimes be an indicator of increased likelihood of corrupt practices because if an employee was dissatisfied with his work, he would be less likely to be concerned about losing his job if corruption was discovered. However, within Fund A, this factor was mitigated by other areas. For a start, Fund A's staff were selected on merit and received good training;³⁹⁸ not only did this keep them motivated, thus increasing levels of staff satisfaction, it also meant that they were highly employable within the private sector. This factor reduced the likelihood of dissatisfied staff engaging in corrupt practices as the fund had close ties to the private sector, particularly the banking industry, and therefore anyone engaging in corrupt practices would ruin their chances of finding employment in banking within Saudi Arabia where the banking industry had

³⁹⁴ Personal communication with interviewee 22

³⁹⁵ Fund B's officials were more than happy to share their manuals.

³⁹⁶ Personal communication with interviewee 33

³⁹⁷ Personal communication with interviewee 21

³⁹⁸ Personal communication with interviewee 16

a relatively low number of firms – fewer than 30 banks. Within Fund B, employees knew what they had to do to achieve promotion as there was transparency in HR policies and procedures. This meant that levels of satisfaction for staff were higher than at Fund A when considering this aspect alone. However, despite the high levels of transparency within Fund B with regard to HR policies, the reality was that in order to be promoted to senior levels within the fund, there was a perception that an employee needed someone influential within senior management to achieve this.³⁹⁹

So, one could conclude that the higher level of transparency was not sufficient for Fund B to have as low a level of corruption as Fund A. Transparency should not be considered on its own as a tool to tackle corruption. The value of transparency is increased when the organisational setting is very well organised. More transparency in Fund A would be expected to play a better role in reducing corruption than in Fund B. For instance, with Fund A's credit policy guide being articulated as a step by step manual and always kept up to date, it was easy for anyone to see how each loan application was handled, therefore the opportunities of corruption were reduced.⁴⁰⁰ In contrast, there was little benefit in publishing how Fund B processes its loans applications as the fund depended on outdated manuals that had been modified by an enormous number of circulars from the Minister of Finance, the board, and the director general.⁴⁰¹ So having more transparency by publishing all these manuals and circulars would not add much in helping internal or external parties to properly scrutinise suspected corrupt loan applications.

However, when it came to actual loan applications Fund A had greater transparency. The name of each loan applicant to Fund A was shown on the application documents – there was no redaction of names of political figures, for example – and all staff who had access to the application knew the name of the person applying.⁴⁰² This contrasted with Fund B where names of highly influential applicants, such as government ministers, were redacted from the application, and so the application proceeded anonymously.⁴⁰³ The selective anonymization of the loan applications by Fund B may have contributed to its higher level of corruption. In particular, by selectively using

³⁹⁹ Personal communication with interviewee 42

⁴⁰⁰ Further discussion of Fund A's manuals is presented in section (3.4.2.4)

⁴⁰¹ Personal communication with interviewee 39

⁴⁰² Personal communication with interviewee 21

⁴⁰³ Personal communication with interviewee 39

asterisks instead of the names of political figures, actors within this organisational context might rationalise corrupt practices based on their perception that some applicants were given preferential treatment to their applications. Whereas in Fund A, where all applications were transparent, this may have encouraged all its officials to refrain from corruption as they knew that all applicants, regardless of their positions, were treated fairly in the same manner.

5.3.3.4 Monitoring anti-corruption strategies

As was the case in hard control anti-corruption strategies, the historical background also played a major role in the development of monitoring anti-corruption strategies. In both funds, path dependency seemed to shape the monitoring control, including internal and external audits.

5.3.3.4.1 Internal audits

While internal audit function in Fund A was established simultaneously with the setting up of the fund by the Western bank,⁴⁰⁴ Fund B did not establish its Internal Audit Department until 2013.⁴⁰⁵ Clearly, this historical initiative by the Western bank had built up a culture of compliance and accountability over thirty years. This indeed contributed to a lower level of corruption in Fund A as all actors in the fund knew before starting any assignment that their work would be scrutinised at some point in time by the Internal Audit Department. This increased the costs of corruption to all actors as a result of a high likelihood of being caught and punished.

Considering the historical emphasis on the importance of having an Internal Audit Department, one could see how the Internal Audit Department had been developed and empowered in Fund A to carry out its duties properly. For instance, in 2005 Fund A's Internal Audit Department consisted of four employees: a secretary, an IT auditor, an operational auditor (whose job was to audit the core business), and the head of internal

⁴⁰⁴ Personal communication with interviewee 12

⁴⁰⁵ Personal communication with interviewee 33

audit. By 2010, as a result of an increase in the total size of the fund, this number had risen to ten employees: the head of department, a secretary, an account auditor, an IT auditor, and six operational auditors. By 2015 the department had expanded further to 15 officials split into two units: an operational audit unit and a separate IT audit unit. All officials working within this department had to complete an intensive training programme, which included working on secondment for seven months with one of the Big Four accountancy firms. Once this training programme had been completed, officials were encouraged to keep training to achieve professional certification in internal auditing. Of the 15 officials employed by Fund A, more than half of them had either a US or Saudi certified public accountant qualification, or both.⁴⁰⁶

In contrast, Fund B did not establish its Internal Audit Department until 2013. Prior to this, there were financial controllers whose focus was on auditing financial transactions. The relatively new Internal Audit Department was established with three units: administrative, technical, and financial. The administrative unit had three officials who had been recently appointed with no prior experience and were responsible for evaluating the performance of Fund B's officials. The technical unit had two officials who had previously worked in similar positions in other areas of the fund for lengthy periods of time and whose duties included ensuring that loans were correctly used for the purpose for which they were intended. The financial unit was responsible for taking samples of disbursements of funds and ensuring that these had been made in accordance with the relevant policies and procedures. Unlike Fund A, the Internal Audit Department in Fund B never audited the core business – whether or not the loan application had been approved in accordance with Fund B's policies and procedures, circulars, and board directives. Also in contrast with Fund A, none of Fund B's internal auditors had professional certificates in auditing, nor did Fund B have anyone dedicated to auditing their IT systems.⁴⁰⁷

After establishing the audit committee in 2013, Fund B's internal auditors started to be empowered in a number of different ways. Firstly, the internal audit committee implemented financial incentives for the internal auditors to achieve professional auditing certification and provided a budget for training their officials. Secondly, they

⁴⁰⁶ Personal communication with interviewee 11

⁴⁰⁷ This paragraph and subsequent one is based on personal communication with interviewee 33

empowered the Internal Audit Department to review certain departments such as the Investment Department, who had previously resisted such scrutiny on the grounds that their work was confidential. In fact, by the end of the field work for this research the Investment Department was still resisting giving access to its information to the Internal Audit Department.

Within their historical context of Fund B, one would expect actors to be less concerned about being detected if they were engaging in corrupt practices. This is because historically, Fund B did not actually have an Internal Audit Department dedicated to scrutiny of the adherence by officials to policies and procedures. This meant that the cost of engaging in corrupt practices (being caught) was historically very low. Even since the establishment of the Internal Audit Department in 2013, the cost of corruption had not increased a great deal. The internal auditors had not been sufficiently empowered to uncover corrupt practices because they were specifically prevented from auditing either the core business or the HR processes. Instead they were limited to auditing the fund's regional branches and accounting and financial transactions.

The approach to the empowerment of the internal audit function can be better understood within the context of each fund. In Fund A, the role of the internal audit was seen as being to add value to the organisation by helping all departments to maintain a high level of compliance with the fund's policies and procedures. This was set by the head of internal audit who gave the internal auditors clear instructions that their approach should be to find breaches at the earliest stage and to advise departments on ways to improve their processes to avoid breaching policies and procedures. This approach was seen as being important for improving Fund A as a whole, and therefore everyone would benefit from such an approach. Interviews with officials from within internal audit and from other departments confirmed that they shared the same understanding of the role of internal audit – that they worked together to achieve Fund A's objectives as a whole.⁴⁰⁸ This did not mean that officials welcomed more audits being done as they were disruptive, but officials understood and appreciated the cooperation they received from internal auditors in highlighting weaknesses in their processes and suggesting improvements that could protect the departments from

⁴⁰⁸ Personal communication with interviewee 12

accusations of malpractice.⁴⁰⁹ For example, the Credit Department had a number of delays in processing some loan applications which were due to delays in receiving information from the Technical or Marketing Departments. Therefore, internal audit recommended that when reports were forwarded from one department to another, the date that this occurred should be recorded. That way it would be clear at what point any delays occurred and which departments were responsible for those delays. This recommendation was seen as safeguarding the Credit Department from being blamed for delays that were not their fault, because they were unable to complete their part of the application process without receiving reports from the Technical and Marketing Departments.⁴¹⁰

The role of the Internal Audit Department within Fund A was based on cooperative, friendly relationships with the departments that they audited. This cooperation started from phase one of the internal audit assignment, whereby an internal auditor spoke to a departmental representative and discussed their procedures and sought to understand any issues that the department had in complying with organisational policies, with the aim of building common understanding between the departments. The cooperation continued through to the final phase, where they discussed the findings of the internal auditors to seek explanations for breaches in policies and procedures prior to the final report being sent to the director general.⁴¹¹

Within Fund B, the approach to internal auditing was completely different. The head of internal audit expected the internal auditors to find mistakes and they received bonuses for doing so. Any auditors who did not find breaches were considered not to be doing their jobs properly. This created a culture whereby any mistakes made by officials which were a breach of a policy or procedure were likely to be hidden from the Internal Audit Department. Therefore, the internal auditors were seen to be working against the departments that they were auditing, rather than with them to improve the fund's processes.⁴¹²

While the level of corruption might have increased in Fund B as a result of the deteriorating relationship between internal auditors and auditees, as corrupt officials

⁴⁰⁹ Personal communication with interviewee 11

⁴¹⁰ Personal communication with interviewee 16

⁴¹¹ Personal communication with interviewee 14

⁴¹² Personal communication with interviewee 33

might have buried corrupt loan applications in amongst a number of non-compliant ones, in Fund A this was not the case. The lack of internal communication did not lead to increased corruption because it was mitigated by Fund A's organisational culture of working together to achieve the same goals. For instance, the lack of communication between the Internal Audit Department and other departments was mitigated by the understanding that internal audit worked with departments to reduce incidences of non-compliance and to fix errors or improve procedures at an early stage, rather than naming and shaming and seeking to blame officials or department managers for every error. So when authority levels for loan applications increased, the poor communication meant that internal auditors were not informed. When these applications under the new regulations were flagged up as non-compliant, the relevant departments pointed out to the internal auditors that the regulations had been changed and that the applicants were compliant with the new regulations⁴¹³. When the same thing occurred at Fund B, many officials used this lack of communication as a weapon to weaken the Internal Audit Department, refusing to inform the internal auditors that the non-compliance cases were actually compliant under new regulations. Instead they would try to undermine the internal auditors' reputation for competence so that either corruptly processed loans could be pushed through as they would be hidden amongst a large number of applications incorrectly flagged as being non-compliant, or just because the officials did not like the internal auditors because of the way that the internal auditors were incentivised to find compliance errors and wanted to make life difficult for them. There was no co-operation between departments and the internal auditors to demonstrate that the regulations had changed and that the loans had been processed in compliance with updated regulations, because the organisational culture of working together had not been established at Fund B.⁴¹⁴

5.3.3.4.2 External audit

Fund A had a deteriorating relationship with external government auditors. This led to greater empowerment of the internal auditors to uncover non-compliance so that the problems could be solved before coming to the notice of the external auditors.

⁴¹³ Personal communication with interviewee 12

⁴¹⁴ Personal communication with interviewee 37

Generally speaking, Fund A's relationship was very defensive with regard to the external government auditors. Most problems arose from increased financial incentives for Fund A's officials, so those officials believed that the external government auditors were biased towards uncovering non-compliance as they were paid a bonus for results.⁴¹⁵

Fund B had a better relationship than Fund A with the external government auditors as they seemed to be open and cooperative regarding suggested improvements to their procedures, to the extent that they replaced some officials as a result of criticism from the external auditors of their work to send a message that they were listening and would try to address any issues raised.⁴¹⁶

So, it can be concluded that the external government auditor played a role in reducing the levels of corruption in the core business of both Fund A and Fund B, but played a limited role in reducing the levels of corruption in the support functions, such as recruitment, which had never been subject to an external government audit.⁴¹⁷

With regard to non-government external auditors, Fund A consistently appointed one of the Big Four accountancy firms as external auditors, keeping in mind their international reputation and ability to find corruption within an organisation.⁴¹⁸

Fund B always appointed a smaller, local firm as external auditors. Their argument was that these firms were cheaper and the fund was obliged by procurement law to accept the lowest tender, and that appointing a cheaper firm was one way of protecting government money from being spent on unnecessary overheads. An interview with one of the Big Four's auditors revealed that Fund B would not appoint them as their fees were about 10 times the price of the local auditing firm that was appointed.⁴¹⁹

It is likely that the appointment of a cheaper, local audit firm did not save the government funds money if the auditors' lack of expertise, or vulnerability to pressure to ignore corrupt practice or at least managerial non-compliance cases with the boards' manual and directions, led to an increase in corruption and fraud. On the contrary, this

⁴¹⁵ Personal communication with interviewee 7

⁴¹⁶ Personal communication with interviewee 3 and 33

⁴¹⁷ Personal communication with interviewees 3 and 7

⁴¹⁸ Personal communication with interviewees 4 and 12

⁴¹⁹ Personal communication with interviewee 4

could have proved a great deal more expensive than appointing an internationally recognised external auditor, despite the increased headline cost of doing so. For example, interviews with one of Fund B's previous external auditors showed that he felt the need to strike a balance between effectively scrutinising Fund B's financial accounts and maintaining the contract to audit the fund. He believed that Fund B's Finance Department resisted providing information or supporting documents that had been requested by the external auditor to verify the validity of some financial transactions. He also admitted that his team lacked the technical expertise to audit the validity of the financial information produced by Fund B's IT systems.⁴²⁰

5.3.3.4.3 Communicating deficiencies⁴²¹

In Fund B, there were set procedures so that the Internal Audit Department reported directly to the board, whereas Fund A's internal audit charter made it clear that internal auditors should report to the director general.⁴²² However, in Fund B this was not rigidly enforced and so the director general saw all reports and edited them before passing information to the audit committee (of which he was a member and at the same time vice chairman of the board).⁴²³ There was clear potential for corruption here as the director general could have kept the board completely unaware of corruption in their organisation.⁴²⁴

Also in Fund B, the Internal Audit Department used to copy the report to the director general of any breaches of procedure within the organisation.⁴²⁵ The director general changed this policy and requested that the Internal Audit Department only informed the management of the relevant department of any breaches of policy, and that he was only to be informed if the breaches could not be successfully corrected. This was a major weakness as the director general could have denied knowledge of any breaches of policies and non-compliance cases within his organisation.

⁴²⁰ Personal communication with interviewee 8

⁴²¹ This section is based on Personal communication with interviewees 12 and 33

⁴²² Personal communication with interviewee 14

⁴²³ Personal communication with interviewee 33

⁴²⁴ Personal communication with interviewee 33

⁴²⁵ Personal communication with interviewee 14

In contrast, in Fund A the Internal Audit Department reported to the director general who reported to the board. The director general chose not to edit the reports before he passed them to the board but this could change in the future if the director general was to leave.⁴²⁶

In Fund A, the internal audit charter itself had its own weaknesses because reports went to the director general who reported the findings to the board. In the past the director general never edited these reports because of his reputation. However, the charter could be strengthened by altering it to say that the Internal Audit Department should report directly to the board, without the director general having seen their reports and recommendations first.⁴²⁷

5.3.3.5 Main features of historical institutionalism

Path dependency could be observed in both funds. The influence of the Western bank that built up the internal control in Fund A could be clearly seen from the way its organisational culture and policies and procedures were transferred to Fund A, and still exist now, more than 30 years after the fund was established. Such influence was vital in starting the fund off on the right foot whereby corruption was not tolerated from the start, leading to the isolation of any corrupt officials who did not adhere to the same values as their colleagues. These practices were then greatly helped by rigid checks and balances that were implemented to establish the correct procedures for lending the fund's money and recruiting officials on merit. The same could be said for Fund B, where experts from a developing country were assigned to set-up the fund's internal control. Many of these experts were widely perceived to have poor ethical standards and competency, leading to continued lower levels of institutional integrity as well as weak hard and monitoring internal control anti-corruption mechanisms, as discussed in preceding chapters. This would tend to support the following hypothesis:

H6: An effective internal control leads to a lower perceived level of corruption when it is established appropriately.

⁴²⁶ Personal communication with interviewee 12

⁴²⁷ For further discussion, refer to section (3.5.2)

Although historical institutionalism seemed to provide a powerful explanation for different levels of corruption, this theory has been criticised for failing to acknowledge that an institution can change its levels of corruption, as history plays a predominant role and historical institutionalism, like all institutionalism, is not good at explaining, let alone predicting, change. If this was the case, there would be little that policymakers could do to control corruption in government organisations. It is on this point that the other two theories can attempt to provide answers to policymakers to overcome this theory's perceived weakness.

For example, historical institutionalism fails to explain the change of corrupt behaviour in 2010 from recruitment to core business when the institutional settings were changed (higher salary, independent recruitment). It also does not explain how corruption changed dramatically in 2015 with change of senior management, as discussed in Section 4.5.

5.4 THE NEED FOR THEORETICAL TRIANGULATION IN DESIGNING ANTI-CORRUPTION MEASURES

As can be seen throughout this chapter, every corruption theory provides different, but still valid, explanations of how internal control impacts corruption.

Agency analysis focuses on the micro level, i.e. on corruption committed by an individual making his own choices. Rational choice neo-institutionalism analysis is at the macro or a group level, and focuses on how corruption equilibrium, or the extent of corruption within an institution, can affect the decisions of all individuals working within a given organisation.

This therefore explains why theoretical triangulation is necessary. The three theories are, on their own, somewhat incomplete. Agency theory focuses on why an individual acts in the way he or she does, but ignores the institutional context – i.e. how colleagues and management can affect the way an individual acts (and how the same individual might act in a different context). Rational choice neo-institutionalism looks at the organisational context and how this might affect an individual's choices, but it cannot provide a solid explanation as to why two seemingly similar institutions can have, at

the macro level, such different levels of corruption *in the first place*. Historical choice theory can certainly show how such organisations can be set on such differing paths, but without looking at how individuals can be incentivised to act honestly, it cannot offer practical solutions to policy makers as to how to reduce corruption levels in institutions. Based on this, the following hypothesis was supported:

H7: The effectiveness of internal control in tackling corruption is better understood with theoretical triangulation.

5.5 CONTRIBUTION TO THE KNOWLEDGE IN THE LITERATURE

While corruption only started to emerge as a separate discipline in the last twenty years, using or prompted by international corruption indices, it has long been discussed by scholars from diverse disciplines in the social sciences, mainly within the criminology, sociology, and psychology literature. However, the focus of such studies is geared toward understanding organisational dynamics, corporate deviance, anomie, misconduct, and white crime collar rather than corruption *per se* (e.g. Braithwaite, 1985; Passas, 1990). For instance, in the criminology literature, corruption is usually examined within the following topics: organised crime, as corruption facilitates its activities (Graaf et al., 2010); globalisation⁴²⁸ (Passas, 1999, 2000); meeting social or organisational expectations (Passas, 1990, 1999); competition for scarce economic resources (Passas, 1990; Vaughan, 1999); a social structure in which access to economic resources by certain social classes is limited if they adhere to the rules (Vaughan, 1997).

⁴²⁸ Passas (1999, 2000) argues that globalization creates criminogenic asymmetries. As defined by Fletcher and Gilmore (2010), criminogenic asymmetry refers to “any type of disparity (asymmetry) between the life situations of individuals or economically independent geographical entities which create circumstances in which there is a potential gain in exploiting the asymmetry through illicit means”. A straightforward example of criminogenic asymmetry can be witnessed in human (or cigarette) smuggling because of different living standards (or prices of cigarettes).

In the context of corruption, Passas differentiates between several types of criminogenic asymmetry such as legal asymmetry (where corrupt companies establish shell companies to bribe foreign officials but still consider them as tax deductible expenses) and power asymmetry (in which public officials have more powers, leading to higher discretion, lower transparency, lower control, and ultimately lower accountability- e.g. authoritarian states). The article urges policy makers to eliminate opportunities of corruption/criminogenic asymmetries, such as revolving door, or at least reduce and control these opportunities with more holistic, cost effective anti-corruption solutions.

With this in mind, this research offers key observations and insights for criminology, sociology, and psychology scholars. Firstly, it offers examples of ways in which corruption is socially constructed and thus the meanings of corruption may differ, not only between two government institutions but also within one government body. One such example is the differing views of westerners and Saudis in Fund A regarding the practice of claiming money for business class travel but booking economy class and pocketing the difference (as discussed in section 3.3.1). Secondly, it shows how interaction between organisational norms, cultures and procedures increases or decreases actors' deviance and misconduct. This is, to some extent, consistent with Vaughan's (1997) findings that organizational culture is socially constructed and plays a major role in shaping, framing, or narrowing actors' choices of ethical or deviant behaviours within a given institution.

The research also offers insights and lessons for studies that examine the interconnection between structure, agency, and history on the development of unethical behaviours (e.g. Passas, 1997), as well as studies that examine the influence of internal pressure on actors' behaviour to engage in or refrain from corporate deviance or illegal practices. Tone at the top, for instance, has been widely discussed in the criminology literature (e.g. Passas, 1990) but with more focus on corporate crimes and deviances. The findings of this research reinforce the findings of previous research in this area.

The following two sections turn to the unique contribution made to the bureaucratic corruption literature in particular. Factors that affect institutional corruption in the literature can be divided into either internal or external control.

5.5.1 Internal Control

This research contributes to the knowledge in a number of ways. For a start, it contributes to the structure and agency debate in the corruption literature (e.g. Persson et al., 2013; Rose-Ackermann, 2010) by showing how bureaucrats' behaviour was shaped by both actors' calculations and corruption equilibrium or the extent of corruption. By deep investigation of the two case studies, this research demonstrates how the combination of both theories could offer a better understanding of bureaucrats' behaviour and lead to better anti-corruption strategies that manipulate actors'

behaviours to be less corruptible. As opposed to taking sides in the institutional integrity vs. institutional incentives campaigns, the research's findings show that both of them are essential in curbing corruption, as they interact with each other. However, more attention should be given to institutional integrity as it provides the context in which institutional incentives operate.

Furthermore, the research contributed to a recent debate in the corruption literature that was centred on the importance of tackling the demand vs. the supply side of corruption. For instance, contrary to the arguments of Neu et al. (2015) that internal control could be employed to enhance actors' ethical behaviour within government institutions, Sikka and Lehman (2015) claim that recent global business corruption cases suggest that super powerful corporations can circumvent internal control as it handles only one side of corruption, i.e. the demand side. Thus, they propose anti-corruption measures to eradicate the supply of corruption, such as debarment of corrupt companies, and prosecution of corrupt corporate executives. By comparing two government institutions within the same market of corruption, this research has shown how Fund A was able to limit corruption by implementing rigid policies and procedures, and empowering internal auditors. Obviously, controlling the demand side of corruption is more feasible and could contribute to lowering the supply of corruption.

The thesis also has also shown support for emerging research in corruption theories (e.g. Hellmann, 2015) that argues that neo-historical institutionalism with its power of path dependency could explain the persistent levels of corruption in developing countries. With this in mind, the following table offers a brief comparison between the corruption literature and the findings of this research.

Table 5.2**The Impact of Internal Control on Corruption**

| # | Factors | Impact on corruption as in the literature | References ⁴²⁹ | Impact on corruption as found in this thesis | Evidence |
|---|--|---|--|--|---|
| 1 | Tone at the top | Medium to High | (Passas, 1990; Thaler & Helmig, 2015) | High | Ethical leadership significantly contributed to different levels of corruption between Fund A and Fund B. |
| 2 | Recruitment on merit | High | (Klitgaard, 2006) | High | The quality of recruitment activities contributed to different levels of corruption in each fund. |
| 3 | Training outside the developing country and secondment | High | (Noor, 2009) | High | Fund's A training and secondment with the Western bank helped in setting both the right institutional integrity and institutional incentives, which in turn contributed to lower levels of corruption. |
| 4 | Written code of ethics | Mixed | (Kaptein & Schwartz, 2008; Thaler & Helmig, 2015) | Low | Code of ethics did not contribute to a lower level of corruption in Fund A as most interviewees were not aware of it. Fund B did not have a code of ethics |
| 5 | Risk assessment | High | (Binti Zamri, Bin Wan Abdullah, & Binti Ahmad, 2015) | Low to medium | Fund A had low levels of corruption before implementing its risk assessment approach. |
| 6 | Rotation policy | High, unless there is systemic corruption in a given organisation | (Abbink, 2004; Rose-Ackerman, 1999; Rose-Ackerman & Palifka, 2016) | High | High turnover in Fund A gave the effect of rotation policy. Some corruption cases were discovered in Fund B when officials were relocated to different branches. |
| 7 | Decentralised management | Mixed | (Birney, 2014; Hanna, Bishop, Nadel, Scheffler, & Durlacher, 2011) | High | The vast majority of corruption cases were within Fund B's branches, leading to the authority to grant loans in several branches being frozen. |
| 8 | The role of the audit committee | Low | (Purcell, 2016) | Low | The role of the audit committee in Fund B was limited because the director general was a member of the audit committee and was in full control and a gate keeper for all internal audit reports. Fund A did not have an audit committee. |

In the literature, procurement is frequently perceived to be vulnerable to corruption in the public sector; yet this did not seem to be the case in the two funds⁴³⁰.

⁴²⁹ These references are just examples.

⁴³⁰ This could be attributed to the small size and nature of business of both funds.

5.5.2 External Control

While the research was not designed to examine the effectiveness of government institutions' external factors in tackling corruption, much evidence emerged during the course of this research that either supported or did not support some of these external factors. The following table summarises this⁴³¹.

Table 5.3
The impact of external control on corruption

| # | Factor | Impact on corruption as in the literature | References | Impact on corruption as found in this thesis | Evidence |
|---|------------------------------|---|---|--|--|
| 1 | Anti-corruption authorities | Low | (De Sousa, 2010; Doig, Watt, & Williams, 2007; Kuris, 2015) | Medium | The training programmes held by the Saudi anti-corruption commission helped internal auditors in both funds to understand high risk areas of corruption. However, they still did not feel confident that they were fully protected when reporting corruption. |
| 2 | Salary | Mixed | (Lambsdorff, 2007; Noor, 2009) | High | After introducing the new salary scale in Fund B in 2010, the number of corruption cases in the core business dropped dramatically as officials were not willing to risk their higher salaries, which were way higher than their market price (or alternative positions) considering their qualifications. |
| 3 | Non-government organisations | Mixed | (Johnsøn et al., 2012) | Very low | Limited number of civil society organisations that fight corruption in Saudi Arabia. With that, Fund A was still able to achieve a low level of corruption. |
| 4 | External auditor | Mixed but more recent research in favour of external auditor | (Boehm, 2011; Neu et al., 2015) | Medium to low | Almost all corruption cases in Fund B were never detected by the external auditor because their focus was on the integrity of accounting records, turning a blind eye to a corrupt organisational culture. |
| 5 | Shoura Council (Parliament) | Mixed but the majority of research is not in favour of parliament | (Hudson & Tsekpo, 2009; Johnsøn et al., 2012) | Low | Many interviewees from both funds highlighted the weak role of Shoura Council in tackling corruption. |
| 6 | Judiciary | High | (Mendelski, 2012) | High | Many interviewees expressed their trust in the judiciary system. One senior manager in Fund B considered the judge's decision as the clear line between corrupt and non-corrupt practices. It should be noted that all corrupt officials in Fund B were punished. |
| 7 | Social media | High | (Katzarova, 2015) | Mixed | Many corrupt practices in Fund B were red flagged on Twitter; but no anti-corruption authority seemed to act on these tweets, most likely because of the enormous number of tweets – in excess of 100,000. |

⁴³¹ For simplicity, the table does not contain all the evidence. For further evidence, refer to the empirical chapters (Three and Four). For instance, in Fund A, the external auditor challenged the board's decision to increase the senior management's incentives, which were introduced to reduce the gap between what the fund paid and what the market paid. So the external auditor in this case was not helping the fund in raising the costs of corruption, assuming that higher salaries minimise corrupt practices.

When internal control is weak, external control often jumps in. For instance, since Fund B appeared to have internal control weaknesses, corruption cases were normally discovered by external controls on corruption, such as anti-corruption agencies and whistleblowing in the social media. The following examples help to illustrate this:

After searching Fund B on Twitter, hundreds of tweets and hashtags were revealed, including one hashtag titled “corruption in Fund B”. This hashtag had tweets on different topics, including:

- (1) Employees’ complaints about unfair distribution of bonuses and promotions
- (2) Delay in processing loan applications, and
- (3) Conflict of interest between the board of director and the executive management.

For instance, one professor from King Saud University, which is the oldest in Saudi Arabia, tweeted on 4th April 2014 that “there is something wrong when you see contradicting and conflicting interests between the board of directors and the executive management. Facilitating the finance of board members is within Fund B’s corrupt practices.”

Another example of external controls uncovering corruption – in this case the Saudi Border Protection - that weak internal control missed, was when a widespread corruption network was discovered in a Fund B branch in the Northern Province of Saudi Arabia. This network involved 13 individuals: three Fund B officials, nine loan applicants, and one facilitator. All of them were convicted and sentenced to between one and four years in prison. According to Al-Watan newspaper (2013), the case was discovered when Saudi border protection officials stopped an individual who was carrying USD 266,000 and questioned its source. Initial investigation revealed that this person had worked as a facilitator for applicants who did not qualify for a Fund B loan, fabricating documents required to successfully apply for the loans. This corrupt facilitator bribed the three Fund B officials to ignore the requirement to conduct field visits before authorising payment of loans. A root cause analysis of this corruption case revealed that decentralized management coupled with weak internal control were the main causes of corruption. Fund B branches were authorized to provide loans of up to

USD 133,000 without referring the application to head office although internal control over its branches was weak. One could infer from this that when internal control is weak, external control will be the second defence against corruption.

5.6 THE IMPORTANCE OF THIS THESIS

This research offers a unique contribution to the corruption literature by providing empirical evidence to back up a list of institutional anti-corruption measures that are often mentioned in the literature but with weak or little empirical foundations. For instance, there is limited research on the effects of training and secondments that are offered from developed to developing countries on corruption. This research has shown such effects supported with figures (e.g. training budgets) and personal experience, with a relatively large number of interviewees at different levels of the hierarchy from different perspectives (e.g. internal auditors, external government and non-government auditors, board members, and anti-corruption authorities).

This also appears to be the first project to test the effectiveness of internal control on tackling corruption with solid methodology. In essence, unlike much corruption research where cases were chosen based on their dependent variables (as documented by Johnsen et al., 2012), this research employed a system design in which cases were selected solely on independent variables. It ruled out alternative hypotheses by including them in the research design, i.e. holding a large number of independent variables constant. This methodology was imperative in providing solid grounds to support the conclusion of this research and revealing insights that are closely linked to the research hypotheses.

This study provides originality by examining the impact of internal control on corruption through theoretical triangulation, namely agency theory, rational choice institutionalism, and historical institutionalism. It argues that policy makers need to consider all of them when designing and implementing anti-corruption reforms in government organisations. This is partially consistent with (Marquette & Peiffer, 2015) arguments on how agency theory and collective action theory can complement each other.

The research findings could help in implementing more successful anti-corruption reforms, by focusing on institutional culture rather than institutional incentives.

Changing organisational culture is more feasible than changing the culture and norms of societies. Through enhancing the effectiveness of internal control in government organisations, the level of corruption will decrease accordingly. Being a champion of the least corrupt government organisations and replicating the same internal control practices in other government organisations is more efficient and more likely to decrease the overall level of corruption.

Finally, prior to this study, the effectiveness of the COSO Internal Control Framework was largely theoretical. This thesis took the lead in examining this globally recognised framework to pinpoint the most important elements of it in tackling corruption and came in response to COSO's call to examine its framework in practice (COSO, 2013).

5.7 STUDY LIMITATIONS

Needless to say there were a lot of difficulties associated with selecting two government organisations with similar system designs and then convincing them to participate in this research. This required the researcher to conduct a pilot study to filter all government organisations listed in the Saudi Corruption Index to find government organisations with a similar nature of business, employment of women, competition etc. Only two government funds met these criteria and were contacted to participate in this research, however fortunately, both of them accepted the opportunity to take part. However, as expected many obstacles arose when the interviews were being set up and in selecting the most knowledgeable officials on internal control practices who were not only willing to talk in a very transparent and honest way but also willing to share documents, and give real examples to support their arguments. Even though the researcher assured every interviewee that his identification would be anonymised and all measures taken to exclude any information that would lead to their identification, only a small number of participants agreed to be audio taped. Most respondents who accepted to be tape recorded were either Western or young Saudi officials. Many of these young officials in Fund B seemed to be very dissatisfied with their organisation and were considering resigning. In Fund A many young officials agreed to allow their

interviews to be recorded because they were supportive of this research. It should be noted that at the end of the fieldwork, some senior officials in Fund B seemed to be annoyed and were always asking “Have you not finished the fieldwork yet?”⁴³² In fact, the director general of Fund B asked the coordinator of this research to inform me that I was no longer allowed to go around all departments and interview officials, instead I would have to act like other researchers and distribute surveys, rather than interview his officials face-to-face. At this point, I had to meet the director general and assure him that the identification of the fund and all officials would be kept anonymous and only a few interviews needed to be conducted to conclude the field work. He then agreed to let me proceed with this research.

It should be noted that it was difficult to gather information on corruption within Fund B because the person being interviewed was either a corrupt official, and therefore not willing to incriminate himself by talking about it, or was concerned about being sacked or otherwise disciplined by a more senior corrupt official. I was able to overcome this issue by triangulating, i.e. asking the same question of different officials within different departments inside or outside the fund (e.g. external auditor) and verifying the outcome of these interviews with documents analysis and observation if possible.

Although I gathered enough evidence to support my argument, it would have been more beneficial to have unlimited access to all databases and documents to trace senior management’s written directions on loan and job applications in order to not only assess their compliance with each fund’s manuals but also to see how senior officials could circumvent hard control activities for personal gains. Furthermore, the outcome of this research would have been strengthened if I had the authority to examine previous corruption cases, but the rules in Saudi Arabia did not allow such practices.⁴³³

As well as all the limitations on conducting research on Saudi government institutions, internal control has its own inherent limitations. As illustrated by the COSO Internal Control Framework (2013), collusion (especially at the senior management level), and human misunderstanding or misjudgement could lower the usefulness of internal control.

⁴³² Personal communication with interviewee 42

⁴³³ This is not like the UK where corruption cases become public records for public scrutiny.

From a corruption perspective, the COSO Internal Control Framework does not provide policy makers with a set of institutional incentives to tackle corruption. Instead, it requires policymakers to adopt risk assessment as it recognises that a 'one size fits all' approach does not work, as well as the fact that corrupt practices evolve over time and it is almost impossible to root out corruption by specific measures. Although this might seem to be a strength of the COSO framework, it is also a weakness as the quality of risk assessment is wholly dependent on the qualifications and integrity of individuals conducting this exercise.

Another weakness of internal control is the ignorance of supply of corruption as this framework was designed to eradicate public official's corruption rather than corrupters (people who offer bribes). However, risk assessment could help in reducing supply of corruption through various channels such as requiring officials to report the corrupter to law enforcement.

The final weakness of internal control as an anticorruption mechanism is that it is more focused on tackling petty corruption. As shown by (Neu et al., 2013, 2015) external factors such as corrupt political leaders could restrict internal control and internal auditors from detecting corruption in the public sector.

All these internal and external factors were kept in mind at different stages of this research. The research examined empirical evidence from different theoretical perspectives to give the full picture of the impact of internal control on corruption. For instance, the COSO internal control does not explain or consider how historical background can shape internal control practices, which in turn affects the levels of corruption. However, this was captured by applying historical institutionalism which considers the effects of path dependency on internal control and corruption.

Other study limitations are common in qualitative research, such as the generalisability of findings to other contexts and trustworthiness. This research attempted to take all precautions to address qualitative research weaknesses, which were discussed in the research design chapter.

5.8 AVENUES FOR FUTURE RESEARCH

This research provides the ground for future researchers in various ways. First, the generalisability of this research could be tested on a larger number of cases by employing qualitative comparative analysis (QCA) or quantitative methods.

Secondly, although the research highlighted the importance of institutional integrity in tackling corruption as it provides the context in which hard anti-corruption control works, limited research has examined how institutional integrity could be monitored. With the increased number of corruption scandals as a result of corrupt institutional culture, this research expects a shift in internal and external audit practices from the traditional way of monitoring hard control activities, such as segregation of conflicting duties and the accuracy of records, to a more focused approach in monitoring the soft control, known as control environment in the COSO framework.

Thirdly, while the principle aim of this thesis was not to test the relative effectiveness of each fund and the extent to which anti-corruption measures has aided or frustrated their effectiveness, I have made certain observations on this (e.g. see section 3.4.2.4), which are worthy of further exploration. In particular, future researchers might be interested in evaluating the extent to which over-rigidly-enforced anti-corruption mechanisms affect the overall achievement of organisational goals.

Furthermore, there are some factors that might play a role in limiting institutional corruption but are not systematically examined in the literature, such as leadership style, culture of professionalism and compliance, levels of efficiency, religious consciousness, personal values and ethics, employees' satisfaction, and loyalty.

In the context of this study, COSO developed its Integrated Internal control framework to be mainly implemented on an organisational level, either in government or non-government sectors (COSO, 2013). However, future research could examine the COSO framework on a country level. In comparison with other international frameworks, such as Transparency International National Integrity (INS), COSO framework could be considered as more holistic for tackling corruption at a national level. The COSO framework does not suggest specific tools to deal with corruption; it only provides a practical methodology (i.e. a general risk assessment approach with commitment to integrity) to design effective anti-corruption reforms that take into consideration

different environments, cultures, values, as well as best practises. It also allows each country to be more creative and establish its own anti-corruption mechanisms, instead of copying successful reforms from other countries. In other words, the COSO framework takes into consideration that one-size does not fit all countries because of distinct cultural, economic, and social backgrounds in each country.

5.9 ADVICE TO POLICY MAKERS

A key aim of this research was to provide practical solutions to the problem of institutional corruption. When formulating policies, the first task is to test them against the pillars outlined in Figure (1.1). Having done so, the following section gives policy-makers further guidelines which should be kept in mind when designing and implementing an internal control framework based on this thesis. The following are considered particularly important:

- The culture of an institution can be changed, but not overnight. The implementation of any policy framework should be considered as a medium- to long-term project before improved outcomes will begin to emerge.
- Tone at the top (leading by example) with a culture of accountability, allied with a meritocratic recruitment and training policy, are by far the most powerful tools not only to prevent corruption, but also to detect and report unethical conduct.
- The establishment of an Internal Audit Department, staffed by well-trained officials who have access to all areas of an organisation. The empowerment of the internal auditors is the priority, rather than merely focussing on how and to whom they report. In addition to this, having a clear cut quantitative standard for audit can play a key role in limiting corruption. However, while it is relatively easy to audit such a standard, and almost impossible for an official to claim to have misinterpreted such a quantitative measure, this is complementary to human intervention, never a replacement for it.
- A continuous, high quality training programme should be followed, that includes secondments of officials to developed countries (where appropriate) to enhance institutional integrity and embed a culture of professionalism within institutions.

- The implementation of a well-designed performance related pay system to provide adequate incentives for officials to adhere to policies and procedures, but not to 'game' the system for personal reward.
- Ethical standards should be embedded into every day policy and procedural guides as used by officials on a regular basis, so that they form part of the process (e.g. by prohibiting the apparent perception of a conflict of interest by any official), rather than including them as a code of conduct in a single (and largely unread) document.
- The appointment of all external auditors should be governed by the issuing of clear guidelines on the size and ability of those bidding to become external auditors to perform the audit function, prior to considering the up-front cost.
- The random (or anonymous, where appropriate) allocation of service providers (i.e. government officials) to service users (i.e. the general public).
- The introduction of a rotation policy for all government officials with a maximum tenure of five years.
- Not to focus on the decentralisation of authority in every case, but to decide on whether this measure is necessary and advantageous on a case by case basis.
- The implementation of a system of checks and balances which are effective, but not so rigid that they are counter-productive to the aims of the organisation.
- The adoption of a compliance-based risk assessment, rather than an objective-based risk assessment might be sufficient to tackle corruption, especially in organisations with low levels of corruption.
- The provision of access to documentation relevant to those who intend to use government services, as transparency in access to many documents reduces information asymmetry between service users and former officials and other 'insiders' who can use this knowledge to enrich themselves by acting as middle men.

- Implementation of a nationwide Internal Control Index that rates all government institutions, having evaluated their performance against the COSO framework, because – as this thesis shows – an effective system of internal controls leads to a lower perceived level of corruption. This makes internal control a good proxy for measuring the level of corruption within any given organisation.

5.10 CONCLUSION

The empirical evidence discussed throughout this thesis supported the hypothesis that corruption comes about on account of deficient internal controls and that therefore effective internal control mechanisms in accordance with the COSO Internal Control Framework are the cornerstone of any institutional anti-corruption initiative. The research argues that this hypothesis is more comprehensive than Klitgaard's corruption formula which only provides a partial explanation of the different levels of corruption in the two funds under examination.

For instance, Fund A is an organisation with high accountability and low discretion, and low levels of corruption, whereas Fund B is an organisation with lower levels of accountability and higher levels of discretion than Fund A and consequently has higher levels of corruption. However, when looking at the levels of monopoly within the respective funds, Klitgaard's formula is less helpful. In Fund A, the director general has near monopoly in the approval of loan applications with only a very small number of very high value loans being submitted to the board for their approval. In Fund B, by contrast, the decentralised nature of the organisation means that regional offices are empowered to make the final decision on loan approvals (up to certain monetary limits), with no need for approval from the director general or the board. In this situation, Klitgaard's analysis suggests that Fund A should have higher levels of corruption than Fund B, but this is clearly not the case.

The reason why Klitgaard's analysis does not fully explain the levels of corruption within an organisation is because it fails to take account of some soft controls, as articulated in the COSO Framework. To illustrate this, one can see how the level of training (which Klitgaard failed to acknowledge) in both funds affected the levels of corruption. For example, within Fund A, a rational actor's high level of training and

professionalism should allow him to ignore any pressure from more senior officials (including the director general) to corruptly circumvent the hard controls proscribed by the credit policy guide because they were likely to be able to leave Fund A for more lucrative employment in a private sector bank. This raised the cost of corruption for the rational actor (he might have struggled to find lucrative alternative employment if fired for corruption from Fund A). Therefore, the director general had limited room for manoeuvre if he was tempted to engage in corruption of this type.

One lesson that could be learned is that if an organisation builds its internal control mechanism based on hard controls only, where every actor is perceived to be selfish/self-interested, it is less likely that they will be completely successful in reducing corruption than if they base internal control mechanisms around soft controls – as well as hard and monitoring controls – that set a culture where corruption is not condoned.

To be more precise, in Fund B the internal control design seemed to be guided by agency theory, which neglects the soft element of internal control, including tone at the top, training, etc. Whereas in Fund A, internal control design was guided by rational choice neo-institutionalism where both soft and hard controls were considered, meaning that even where there were opportunities for corruption, the instinct of most of the staff would be not to take that opportunity, but to act in a more ethical manner than agency theory might predict. In other words, the power of expectation would play a major role in raising the costs of corruption as many officials expect their colleagues to act ethically just like them. Such an expectation would reduce the opportunity of collusion, which is often recognised as the main hindrance or the main limitation of COSO Internal Control Framework.

What is also clear is that having the right soft control in each fund also seemed to influence the quality of hard internal control. In Fund A, the quality of its written manuals (hard control) could be easily linked to its ethical atmosphere, culture of accountability, and clean recruitment process, coupled with systemic intensive training programs for all its officials across the board. The implication was that the state of the art manuals that were established by Western experts were kept updated and enforced by competent Saudi officials at all levels within the fund.

The conclusion of this research might contradict other studies that questioned the significance of internal control. This could be because a great deal of other research has understood (and therefore concentrated on) internal control as policies and procedures. However, this research has widened its scope to include the importance of implementing more elements of the COSO Internal Control Framework.

One of the findings of this research was that a single internal control often does not work on its own – the three internal controls need to be established together. If one of the internal controls is missing, then the anti-corruption efforts of the entire organisation are in danger of collapsing. For instance, even when both a soft control strategy and a hard control strategy were in place in Fund A with regard to senior management working through their lunch breaks, demonstrating a good example for their highly educated, moral professional employees to follow, and with a policy regarding the amount of time to be taken for a lunch break in place, because there was no attempt to monitor this, the lower level officials routinely took extra time off at lunch time.

Therefore, without analysing how individuals react to individual incentives, and how individuals react to a specific corruption equilibrium within a given organisational context, and without looking at how a given organisational context came into being in the first place, any anti-corruption framework is likely to be inadequate, and therefore can only provide partially successful practical solutions to the problem of corruption within an organisation. This thesis has used theoretical triangulation to assess the issue of corruption and how best to reduce its level from a micro or individual level, from a macro or institutional level, and from a historical perspective. As a result, it provides originality in terms of demonstrating how these theories can work together to provide a practical, holistic set of solutions that organisations can apply in order to set up an anti-corruption internal control framework. If applied correctly, with due regard to its limitations, such a framework can reduce levels of corruption within an organisation, and encourage an organisation-wide culture that maintains corruption at acceptably low levels.

Appendix 1: Interview questions



Interview Question:

After participants read the information sheet (see appendix 3) and signed the consent form (see appendix 4), I asked them the following questions.⁴³⁴

1. Can you please brief me on your job, experience (i.e. number of years) and qualifications?
2. Based on your job experience, what does “internal control” mean in practice? How and why have they evolved in your organisation over the past 5 to 10 years?
3. To what extent do you think control environment principles, such as governance, accountability, ethics, and HR policy are important for shaping internal control in your organisation? Which one of these principles is most effective in tackling corruption?
4. How does your organisation identify or assess corruption risks such as conflicts of interest?
5. What measures has your organisation taken to address these risks (i.e. corruption risks)?
6. With regard to internal control’s objectives, responsibilities, and challenges, what information does your organisation communicate to all related parties,

⁴³⁴ It should be noted these questions are intended as a guide only, and further questions may be added or amended based on the discussion with each interviewee. Sometimes these questions are translated to Arabic in case the interviewees do not understand English.

such as employees and the board of directors, and how? Do you think the information is sufficient for these purposes?

7. How does your organisation monitor the effectiveness of internal control?
8. In your opinion, how effective is internal control in tackling corruption in comparison with other anti-corruption mechanisms, such as increasing salary scale, employment of women, and privatization?

Appendix 2: Gatekeeper Letter



Template for gatekeeper letter:

This letter was sent to directors of government organisations in order to obtain their approval to commence the project in their organisations. I had to obtain their approval before approaching the potential participants of the study. This letter was adapted as appropriate, such as translated into Arabic.

Dear.....,

I am a PhD student at the University of Sussex, Brighton, UK. I am writing to obtain your approval to conduct my research at your respected organisation. My research title is “The effectiveness of internal control in tackling corruption: the case of Saudi Arabia”.

The main focus of this study is on how internal control could be used to tackle corruption in the public sector. Taking the case of Saudi Arabia, the researcher attempts to understand the relationship between internal control and corruption. In particular, how internal control has been utilized in Saudi government agencies to tackle corruption.

As part of this study, I will conduct interviews with individuals working in the Internal Audit Department as well as random interviews with officials who are aware of internal control practices in your organisation.

All participants’ personal information will remain confidential to the researcher, and all information will be securely stored so that participants’ privacy is protected. Please find attached an information sheet that explains my study in more detail. If you have any questions, please do not hesitate to contact me at:

Email: N.Abaalkhail@sussex.ac.uk

Phone number: +966504474284.

Best Regards,

Nassar Abaalkhail



PARTICIPANT INFORMATION SHEET

Study title:

The effectiveness of internal control in tackling corruption: the case of Saudi Arabia.

Invitation to participate in a study:

You are being invited to participate in a research study. Before you decide whether or not to take part, it is important for you to understand why the research is being undertaken and what it will involve. Please take time to read the following information carefully.

What is the purpose of the study?

The main focus of this study is to determine how internal control could be used to tackle corruption in the public sector. Taking the case of Saudi Arabia, the researcher attempts to understand the relationship between internal control and corruption; in particular, how internal control has been utilized in Saudi government agencies to tackle corruption. This thesis adopts a qualitative approach to data collection and analysis.

Why have I been invited to participate?

Since article 14 of the Saudi Internal Audit Regulations lays the responsibility of evaluating the effectiveness of internal control on internal auditors, interviews will be conducted with all individuals working in Internal Audit Departments in government

agencies. Furthermore, random interviews will be conducted with officials who are aware of internal control practices in government agencies.

Do I have to take part?

It is up to you to decide whether or not to take part. If you do decide to participate you will be given this information sheet to keep and be asked to sign a consent form. You will also remain free to withdraw at any time and without giving a reason.

What will happen if I take part?

If you agree to be interviewed, you will be asked to read and sign a consent form. The interview consists of approximately nine semi-structured interview questions and may take between 40-60 minutes. After each interview, you will be asked to review and approve the interview transcript to ensure its accuracy and precision. This step can be done at the end of each meeting or via email. If you prefer to approve the transcripts via email, please provide me with your email address in the consent form.

What are the possible disadvantages and risks to taking part? (where appropriate)

There are no risk or disadvantages to taking part in this study.

What are the possible benefits of taking part?

Your participation is vital in order to deepen our understanding of the role of internal control in tackling corruption in the public sector. The outcome of this research will not only benefit Saudi Arabia but it would also enrich the literature on corruption prevention mechanisms.

Will my information in this study be kept confidential?

All information collected during the study is solely for research purposes and will be kept strictly confidential and private. Your name will be anonymous and your identity will be concealed in the collection, storage, and publication of research materials. The research data will not be used for any purpose other than that for which consent is given. Your personal information will be protected in accordance with the UK's Data Protection Act 1998.

What should I do if I want to take part?

If you wish to take part, please let me know a time and date that is convenient for you either in person, by email (N.Abaalkhail@sussex.ac.uk) or over the phone (+966504474284). The interview can be conducted at your office or wherever would be most convenient for you.

What will happen to the results of the research study?

The results of the research will be used in my PhD thesis at the University of Sussex. They might also be published; however, your name and personal information will always remain anonymous and never be disclosed.

Who is organising and funding the research?

I am conducting the research as a doctoral researcher at the Sussex Centre for the Study of Corruption, University of Sussex. I am funded by the Saudi Cultural Bureau, London, UK.

Who has approved this study?

This study is approved by the Social Sciences & Arts Cross-schools Research Ethics Committee (C-REC).

Contact for Further Information

If you wish to participate in this study or have any questions, please do not hesitate to contact Nassar Abaalkhail

Email: N.Abaalkhail@sussex.ac.uk

Phone number: +966504474284

Should you have any concerns about the way in which the study is conducted, please contact Professor Dan Hough, Director of Sussex Centre for the Study of Corruption (SCSC), School of Law, Politics and Sociology, Email: d.t.hough@sussex.ac.uk

Phone number: +44 1273 877648 or +44 1273 678578

Thank you for taking the time to read this information sheet

Date

Appendix 4: Consent Form for Project Participants



CONSENT FORM FOR PROJECT PARTICIPANTS

Project Title: The effectiveness of internal control in tackling corruption: the case of Saudi Arabia

Project Approval Reference: ER/NA309/1

I agree to take part in the above University of Sussex research project. I have had the project explained to me and I have read and understood the Information Sheet, which I may keep for records. I understand that agreeing to take part means that I am willing to:

- ☐ Be interviewed by the researcher
- ☐ Allow the interview to be audio taped
- ☐ Make myself available for a further interview should that be required

I understand that any information I provide is confidential, and that no information that I disclose will lead to the identification of any individual in the reports on the project, either by the researcher or by any other party.

I understand that I will be given a transcript of data concerning me for my approval before being included in the write up of the research.

I understand that my participation is voluntary, that I can choose not to participate in part or all of the project, and that I can withdraw at any stage of the project without being penalised or disadvantaged in any way.

I consent to the processing of my personal information for the purposes of this research study. I understand that such information will be treated as strictly confidential and handled in accordance with the Data Protection Act 1998.

Name:

Signature:

Email (in case you prefer to approve the transcript via email):

Date:

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