

ROLE OF INTERNAL AUDIT SYSTEMS IN ENHANCING FINANCIAL ACCOUNTABILITY AND ECONOMIC EFFICIENCY IN EMERGING ECONOMIES

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Abstract

This study examines the role of Internal Audit Systems (IAS) in enhancing financial accountability and economic efficiency in emerging economies. In an environment characterized by institutional volatility, governance weaknesses, and increasing demands for transparency, internal audit functions have evolved from traditional compliance-based mechanisms into strategic governance tools. Drawing on agency and stewardship theories, the paper conceptualizes internal audit as both a monitoring mechanism to reduce information asymmetry and a value-adding function that supports organizational performance and resource optimization. The study synthesizes existing literature to demonstrate that effective internal audit systems significantly improve financial reporting quality, strengthen regulatory compliance, and reduce risks of fraud, corruption, and wasteful expenditure, particularly in public sector organizations. Empirical evidence from emerging economies indicates that strong internal audit practices are associated with improved budgetary control, reduced over-expenditure, and enhanced accountability in both corporate and governmental institutions. Furthermore, the paper highlights the contribution of internal audit to economic efficiency by improving resource allocation, strengthening investment oversight, and supporting public investment project performance. However, it also identifies persistent structural challenges, including political interference, limited institutional independence, skills shortages, and inadequate technological adoption, which constrain audit effectiveness in developing contexts. Finally, the study explores emerging trends such as digital auditing, artificial intelligence, and Environmental, Social, and Governance (ESG) assurance, emphasizing their potential to transform internal audit into a more proactive and strategic function. The paper concludes that strengthening internal audit systems through institutional reforms, capacity building, and technological integration is essential for promoting sustainable economic development and governance resilience in emerging economies.

1. Introduction

The global financial landscape has entered an era defined by extreme volatility, technological disruption, and a heightened demand for institutional integrity (Oko-Odion & Angela, 2025). In emerging economies, which often serve as the engines of global growth while grappling with institutional voids, the role of internal audit systems has transitioned from a routine compliance function to a strategic cornerstone of financial accountability and economic efficiency (Udoh, 2024). As these nations strive to integrate into global capital markets, the robustness of their internal governance mechanisms becomes a primary determinant of their ability to attract sustainable investment and maintain social trust (Tseng et al., 2019).

Modern internal auditing is most effective when performed by professionals who strictly adhere to international standards, ensuring that organizational goals are met while maintaining independence from management (Pangastuti, 2023). The evolution of the internal audit function reflects a broader shift in corporate and public governance, moving beyond the traditional verification of financial records toward a proactive, risk-based approach that seeks to add value, improve operations, and secure the long-term resilience of organizations (Usul & Alpay, 2025).

2. Theoretical and Historical Foundations of Internal Audit Systems

The conceptual history of internal auditing is marked by a significant transformation in scope and purpose. Initially, the function was primarily focused on the narrow task of checking accounting entries and preventing simple theft or errors a role often described as the "watchdog" approach (Behrend & Eulerich, 2019). Over the latter half of the twentieth century, and accelerating significantly in the twenty-first, this role expanded into the monitoring of internal controls and compliance with increasingly complex legal frameworks (Kummari, 2025). Today, the IIA defines internal auditing as an independent, objective assurance and consulting activity

designed to add value and improve an organization's operations (Engelbrecht et al., 2018).

2.1 The Evolution of Internal Control Frameworks

The modern internal audit system is grounded in the evolution of internal control frameworks, most notably those developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (Ferdia & Kammoun, 2024). These systems encompass practices ranging from physical security and audit trails to sophisticated governance protocols, all aimed at safeguarding assets, preventing fraud, and ensuring the reliability of financial reporting (Ogunsola et al., 2021). The 2013 and 2017 COSO updates emphasize the integration of internal controls with risk management and governance, reflecting the need for adaptive and dynamic systems in a globalized environment (Tahsaldar et al., 2026).

In emerging economies, the adoption of these international standards is often a key component of economic reform. For example, Vietnam issued new regulations in 2019 to guide the implementation of internal audit functions in alignment with international standards, seeking to bolster the development of its corporate governance landscape (Bui & Nguyen, 2025). This standardization is viewed as a mechanism to enhance the maturity of the internal audit function, which in many developing nations still operates at a rudimentary level (Engelbrecht et al., 2018).

2.2 Theoretical Lenses: Agency and Stewardship Perspectives

The scholarly discourse on internal audit effectiveness frequently utilizes two competing but complementary theoretical lenses: Agency Theory and Stewardship Theory (Khalid & Sarea, 2021). Agency Theory posits that internal auditing serves as a monitoring mechanism to reduce the conflicts of interest between principals (such as shareholders or taxpayers) and agents (management or government officials) (Al-Faryan,

2024). By reducing information asymmetry, internal audit limits the opportunity for management to engage in opportunistic behavior, such as pursuing short-term gains at the expense of long-term value or diverting public funds for personal use (Nurgaliyeva et al., 2025).

Conversely, Stewardship Theory views the internal auditor as a partner to management, focused on the collective achievement of organizational objectives (Ajaegbu & Mmayie, 2025). In this framework, accountability is not merely about policing but about ensuring that resources are used effectively to meet the entity's mandate, thereby building public trust (Hope Sr, 2021). The integration of these theories allows for a nuanced understanding of how internal audit contributes

to both accountability (enforcement of rules) and efficiency (optimization of outcomes) (Ahmad & Muslim, 2024).

3. Internal Audit as a Pillar of Financial Accountability

Financial accountability is the obligation of an organization to provide evidence that its resources have been managed in accordance with legal and ethical standards (Dwangu & Mahlangu, 2021). In emerging economies, the internal audit system is the primary internal mechanism for ensuring that financial statements are free of material misstatements and that operational activities comply with regulatory requirements (Odetunde et al., 2021).

Figure 1. Key Strategic and Operational Benefits of the Internal Audit Role



3.1 Enhancing Financial Reporting Quality

A robust internal audit function is positively correlated with the quality of financial reporting. Studies indicate that firms with higher levels of internal audit compliance with international

standards generate more reliable financial information (Hegazy & Farghaly, 2021). The internal auditor's role in evaluating the accounting and financial functions specifically in terms of risk and control systems enhances the overall

governance framework (Ogunsola et al., 2021). In Saudi Arabia, research has confirmed that efficient audit committees and internal audit functions significantly contribute to the quality of financial

reporting, providing the board with the assurance needed to fulfill their oversight duties (Alhumoudi, 2024).

Table 1. Impact Factor of Internal Audit on Financial Accountability

Impact Factor	Descriptive Mechanism
Risk-Based Assurance	Evaluating the adequacy of controls to mitigate financial misstatement risks.
Regulatory Compliance	Verifying adherence to evolving national and international accounting standards (e.g., IFRS).
Audit Committee Liaison	Providing independent reporting channels that bypass management to ensure objective oversight.
Fraud Detection	Identifying irregularities through systematic appraisal of financial documents and operational reviews.

3.2 The Public Sector Context: Detecting and Preventing Corruption

In the public sector of emerging economies, internal audit plays an essential role in saving public monies and limiting corrupt practices (Abdulhussein et al., 2023). Public procurement, in particular, is identified as a high-risk area due to its exposure to fraud, corruption, and weak accountability (Paraskeva & Tsoulfas, 2025). Internal audit functions are expected not only to ensure compliance with procurement regulations but also to enhance transparency and detect irregularities before they lead to significant financial loss (Netshifhefhe et al., 2024).

Research highlights that an effective internal audit function is a critical pillar for an organization's survival, adding value by detecting irregularities

and supporting the administration in maintaining integrity and ethical standards (Ogunsola et al., 2021). When internal audit is successfully implemented, it provides assurance regarding information security and helps protect the organization's resources from "cybercrime" and other emerging threats (Iting et al., 2024).

3.3 Empirical Evidence from South Africa

Quantitative analysis of the South African provincial treasuries provides compelling evidence of the link between internal audit effectiveness and financial accountability. Findings indicate that a unit increase in the internal audit score leads to a measurable decrease in over-budgeting across various expenditure programs (Mashaphu, 2023).

Table 2. Reduction in Over-Budgeting per Unit Increase in Internal Audit (IA) Score

Provincial Expenditure Program	Reduction in Over-Budgeting (Points)
Financial Governance	0.90
Administration	0.62
Sustainable Resource Management	0.06
Internal Audit	0.03
Municipal Finance Management	0.02

The study further discovered that the internal audit function has a direct negative relationship with wasteful and fruitless expenditure. For every unit increase in the internal audit score, there is a 0.23 point decrease in wasteful expenditure across the provinces (Mirzaei et al., 2024). These results

suggest that internal audit should be embraced as a monitoring tool to evaluate service delivery performance rather than being viewed as a punitive initiative (Moodley, 2019).

4. Driving Economic Efficiency and Value Creation

Economic efficiency involves the optimal distribution and utilization of resources to achieve maximum output. In emerging economies, the internal audit function contributes to economic efficiency by improving risk management, identifying operational bottlenecks, and providing strategic insights that facilitate better decision-making by senior management (Turetken et al., 2020).

4.1 Resource Allocation and Operational Efficiency

Internal auditing is an essential component that helps distribute resources as efficiently as possible (Postula et al., 2020). By conducting systematic evaluations of business operations, internal

auditors uncover inefficiencies and offer solutions that power real decisions at the highest levels of the organization (Nerantzidis et al., 2022). In firms where the internal audit function is mature, it acts as a catalyst for management to have a deeper understanding of governance processes and structures, thereby provoking positive change and innovation (Pangastuti, 2023).

In the context of firm operational efficiency, internal audit quality can improve performance by giving strategic recommendations for management (Chiarini et al., 2021). This is particularly evident in studies where a positive association is found between high-quality internal audit functions and the achievement of organizational goals (Jiang et al., 2018).

Figure:2 Conceptual Framework Linking Resource Efficiency to Organizational Benefits



4.2 Securing Public Investment Projects

In emerging economies such as India, Brazil, Morocco, and Vietnam, internal auditing has emerged as a critical tool for securing public investment projects with high capital content

(Yousra & Dafri, 2024). These projects are often plagued by budget overruns, delays, and inefficiencies. Internal audit secures these projects from the opportunity review and tendering phases

through to the monitoring of costs, deadlines, and benefits (Okei, 2025).

Recent IMF studies suggest that emerging economies could increase infrastructure output by an average of 54% if inefficiencies in public investment management were eliminated a "dividend of efficiency" that is largely dependent on the robustness of internal controls and governance (Schwartz et al., 2020). Internal auditing, by strengthening transparency and the efficiency of resource allocation, is a central mechanism for realizing this dividend (Syahputra, 2022).

4.3 The Impact on Investment Efficiency

The relationship between internal audit and investment efficiency is a subject of ongoing empirical research. In Indonesia, a study of non-financial public listed firms found that the internal audit function actually had a negative effect on corporate investment efficiency during the period of 2016 to 2019 (Soliman, 2020). This finding suggests that in some emerging economies, the internal audit function still plays only a minor role in corporate strategic decisions and may be focused too heavily on traditional financial reporting and compliance the "watchdog" role rather than value-added advisory services (Engelbrecht et al., 2018). This underscores the importance of transitioning the audit function toward a more strategic orientation to truly enhance investment outcomes (Yunis et al., 2024).

5. Governance Challenges in Emerging Economy Structures

The unique structural characteristics of emerging economies including the dominance of State-Owned Enterprises (SOEs) and family-owned business groups create specific challenges and

opportunities for internal audit systems (Lu, 2021).

5.1 Corporate Governance in State-Owned Enterprises (SOEs)

SOEs are responsible for a significant portion of business activity and 55% of infrastructure investment in developing nations (Le et al., 2023). However, these organizations often suffer from poor performance due to "multiple principals and agents" problems, where power is delegated to politicians and public servants who may have their own interests to safeguard (Pauw, 2025).

Research shows that the presence of civil servants and directors with political affiliations in government-controlled companies has a negative effect on enterprise value (Abolhassani et al., 2020). Internal audit in this context is frequently compromised by political intervention, which can disrupt the independence of the function and lead to reports that minimize risks to satisfy public authorities (Boufounou et al., 2024). Strengthening the independence of the board and the audit committee is essential to insulate the internal audit function from such interference and ensure it can effectively monitor management (Benichou, 2024).

5.2 Family-Owned Business Groups and the GCC Context

In regions like the Gulf Cooperation Council (GCC), family-owned businesses often blend personal and professional interests, which complicates governance and financial oversight (Chalhoub, 2025). One of the most common challenges is the overlap between family wealth and business resources, where family members may use company funds for personal expenses. This lack of separation can lead to misstated financial reports and hinder compliance with international standards (Carney & Nason, 2018).

Table 3. Audit Challenges in Family Businesses and Strategic "Ways Forward"

Audit Challenge	Strategic "Way Forward"
Separation of Finances	Implementing clear policies for categorization of business vs. personal expenses.

Succession Planning	Establishing transparent, legally supported plans to reduce risks during generational shifts.
Transparency Resistance	Building trust between auditors and family members to overcome fear of external scrutiny.
Governance Formality	Introducing independent board members and formalized audit committees.

Internal auditors in these firms must combine technical expertise with cultural awareness to navigate sensitive issues such as related-party conflicts (Hoor et al., 2025). The "Three-Circle Model" (Family, Business, Ownership) is a useful tool for understanding how these overlapping subsystems create the need for a more formal management and audit structure as the company evolves from a controlling owner to a cousin consortium (Al-Sarraf, 2019).

5.3 Ownership Concentration and Minority Rights

Emerging markets are often characterized by high levels of ownership concentration, which can lead to the risk of management entrenchment and the expropriation of minority shareholders (Jabbouri & Naili, 2020). In Latin America, the level of ownership concentration has remained high, with the largest owner often holding over 50% of shares (Mihus, 2024). This leads to weak legal protection of minority interests and requires internal audit systems to play a more robust role in ensuring that corporate value creation is shared on fair and equitable terms (Pangastuti, 2023).

6. Critical Success Factors for Internal Audit Effectiveness

The effectiveness of an internal audit system is not inherent but is influenced by several critical organizational and institutional factors (Abdelrahim & Al-Malkawi, 2022).

6.1 Management Support and Resource Empowerment

Upper management support is considered one of the most vital drivers of internal audit effectiveness

(Roussy et al., 2020). Senior management must provide the internal audit department with sufficient resources, competent staff, and continuous training opportunities (Lois et al., 2020). Without this support, auditors cannot achieve their appointed objectives or add value to the organization (Reichborn-Kjennerud, & Johnsen, 2018). Empirical surveys in Vietnam indicate that management support and the presence of an audit committee are significantly impacted factors on the overall effectiveness of the function (Khoa, 2024).

6.2 Independence and Objectivity

To be effective, internal auditors must be empowered to execute their duties without interference (Njagi, 2023). This requires a direct reporting link to the board or the audit committee, allowing them to remain independent of the management they are auditing (Almasria, 2022). The board must establish and protect this independence to elevate the value of the assurance and advisory services provided (Akinsola & Taofeek, 2025). High levels of autonomy are shown to increase the integrity and accountability of audit reports (Qader & Cek, 2023).

6.3 Staff Quality: Education vs. Experience

The human capital component of internal auditing is critical. Research from South African provincial treasuries found that the educational qualifications of management staff were more impactful than their professional experience in achieving financial control (Enwereji & Uwizeyimana, 2019).

Table 4. Staff Attribute Correlation with Expenditure Control

Qualification/Attribute	Correlation with Over-Budgeting
Higher Education (NQF 8+)	Strong Negative Correlation (-0.02)
Professional Experience (5+ yrs)	Smaller, localized impact (-0.04)

6.4 Collaboration with External Auditors

The relationship between internal and external auditors is a key influencer of audit impact (Azzam et al., 2020). Cooperation through the exchange of reports, ideas, and information leads to higher audit quality, prevents the duplication of work, and ensures that audit resources are utilized efficiently (Shesternyak & Zabchuk, 2024). The legal framework and mutual trust are the primary factors that determine the success of this cooperation (Ronsfeld, 2023).

7. Barriers to Implementation in Emerging Economies

Despite the theoretical benefits, internal audit systems in many emerging economies still fall short of international best practices (Shaban & Barakat, 2023).

7.1 Institutional "Underprioritization"

World Bank PEFA (Public Expenditure and Financial Accountability) findings show that 86% of internal audit departments in assessed jurisdictions operate at a "basic" or substandard level. Only 2% achieved an "A" score for compliance with best practices (Kim et al., 2020). In many cases, internal audit remains underprioritized despite years of public financial management reforms, often being perceived as a box-checking exercise rather than a tool for improvement (Gautam et al., 2025).

7.2 Political Pressure and Manipulation

Internal auditors frequently face intense political pressure to manipulate findings. A survey of North American CAEs which provides a baseline for even more challenging environments revealed that nearly 55% were directed to omit or modify

important findings, and 49% were told not to perform work in high-risk areas (AL Fayi, 2022). These pressures range from subtle budget cuts to overt threats of firing (Frye et al., 2019). In emerging economies like Morocco, political intervention often disrupts the independence of the function, making reports less reliable (Caligiuri & Sabatini, 2021).

7.3 The Technological and Skills Gap

The lack of appropriate technology and a shortage of skilled personnel are primary barriers to increasing the effectiveness of internal audit (Matshona, 2020). Many internal audit teams in the public sector haven't been trained in risk-based or performance auditing, and they lack the infrastructure needed to adopt modern audit tools (Emmanuel, 2025). Furthermore, as economies experience talent shortages, government pay scales are often insufficient to attract or retain the necessary expertise (Sheehan et al., 2018).

8. Future Horizons: Digitization, AI, and ESG

The future of internal auditing is being shaped by two defining governance challenges: the integration of Artificial Intelligence (AI) and the rise of Environmental, Social, and Governance (ESG) mandates (Sheta et al., 2025).

8.1 The Rise of Agentic AI and Digital Auditing

Advancements in technology are redefining the audit profession, driving transparency and accuracy in ways previously unimaginable (Celestin et al., 2024). "Agentic AI" and big data analytics allow auditors to process vast volumes of structured and unstructured data, moving beyond traditional sampling to analyze full data sets in real-time (Bose et al., 2023).

Table 5. AI Technology in Audit and Primary Benefits

AI Technology	Primary Benefit
Machine Learning	Pattern recognition and advanced fraud detection.
Natural Language Processing	Automating the analysis of unstructured data (contracts, text).
Predictive Analytics	Assessing potential future risks to allow for preventive action.
Blockchain	Enhancing the integrity and traceability of financial transactions.

In emerging markets like Saudi Arabia, AI is being strategically deployed under Vision 2030 to monitor carbon emissions and promote workforce inclusion (Sepehri et al., 2024). However, there is a recognized "credibility gap," as many internal auditors currently lack the knowledge to audit AI risks effectively, with only 28% of survey respondents feeling confident in their teams' ability to do so (Ilori et al., 2023).

8.2 ESG Auditing: The New Frontier of Governance

ESG factors have moved from the periphery to the center of corporate governance. Regulatory frameworks are rapidly mandating ESG disclosures, and investors are incorporating these metrics into their decisions (Quttainah, 2025). For internal audit, this presents a unique challenge: reporting obligations are expanding faster than internal controls and data quality can keep pace (Leocádio et al., 2024).

Internal audit's role in ESG includes evaluating data collection processes, the consistency of reporting boundaries, and the adequacy of internal controls over sustainability data (Harasheh & Provasi, 2023). In emerging economies, robust ESG practices are essential for promoting financial stability and long-term value creation (Meneses Cerón et al., 2026). The audit function that can provide meaningful assurance on ESG will achieve a strategic relevance that traditional financial auditing alone cannot deliver (Arustamyan, 2025).

8.3 Toward "Audit 2030": Continuous Monitoring and Resilience

The vision for the next decade of internal auditing involves a shift toward continuous monitoring, agile auditing, and a focus on operational resilience (Wurzer & Plattfaut, 2024). This

requires internal auditors to be "trusted advisors" who provide not just assurance but strategic foresight (Auditing & Accountability, 2025). However, as of 2026, many internal audit functions are still viewed by their organizations as "compliance-focused" or "the police" (Fauzan et al., 2026). Bridging this perception gap is critical for the survival of the profession, as audit functions that are seen as low-value will be highly vulnerable to being displaced by AI-driven processes (Habbach & Östlund, 2025).

9. Strategic Recommendations for Enhancing Audit Effectiveness

To fully realize the potential of internal audit systems in emerging economies, several institutional and organizational shifts are required (Usul & Alpay, 2025).

9.1 Strengthening the Institutional Framework

Governments and regulatory bodies must ensure that internal audit has the independence it needs, backed by law (Njagi, 2023). This includes establishing a central function to develop internal control and audit systems and ensuring that integrity risks are included in public organizations' risk assessments (Safina, 2018). Reforms should aim to professionalize government ownership and develop more independent boards for SOEs to insulate them from political interference (Guan et al., 2021).

9.2 Investing in Human Capital and Training

Capacity development is essential. Organizations must invest in their people through training, certification, and peer learning (Darmawan, 2025). This is particularly important for risk-based and performance auditing skills, which are currently lacking in many emerging markets (Munthe et al., 2025). Pay scales must also be

adjusted to attract and retain the high-level expertise needed for modern auditing (Kamaruddin & Zakaria, 2025).

9.3 Adopting Digital and Global Standards

The adoption of international frameworks, such as the IIA Global Internal Audit Standards, provides a solid foundation for growth (Gegeza, 2025). Furthermore, the digitization of the audit function through modern tools and data analytics can assist teams in improving efficiency and focusing on key risk areas (Popara et al., 2023). In emerging markets, leveraging technology is no longer a "leading practice" but a requirement for meeting stakeholder expectations (Steenkamp, 2018).

Conclusion

The research concludes that Internal Audit Systems serve as the backbone of economic resilience in emerging markets by aligning institutional operations with international transparency standards. Financial accountability is not merely a legal obligation but a driver of economic efficiency, as it reduces the "risk premium" associated with opaque financial environments. However, the effectiveness of these systems is heavily contingent upon institutional independence and the integration of advanced technological tools to handle increasingly complex financial data. For emerging economies to sustain long-term growth, they must move beyond symbolic compliance and empower internal auditors with the autonomy and resources necessary to act as objective "watchdogs" of economic integrity.

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