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Krzysztof Ćwieląg
University of Opole

INTERNAL AUDIT IN SELF-GOVERNMENT ENTITIES IN POLAND. A THEORETICAL AND EMPIRICAL APPROACH

Summary: In the article there has been described an instrument of the internal audit, premise for its introduction, its purpose, the scope and place in the sector of the public finance, with special consideration for the requirements and procedure of the internal audit execution in the self-government entities in Poland. On the basis of conducted examinations, there were made some analysis of the internal audit operation in the self-government sector, with its most important elements taken into account. Based on the findings, a number of final conclusions have been formulated.

Keywords: self-government entities, internal audit, organization, tasks.

1. Introduction

The year 2010 is the ninth year of the internal audit operation in the public sector in Poland. The past period can induce reflection over the current internal audit execution, bearing in mind that in recent times the role and meaning of the audit as the instrument of managing local government in the system of public finance, including self-government entities funds, has increased considerably. The internal audit is an institution which is still subject to a rapid development in its conception, its organization and tasks, of which consecutive statutory amendments attest, as well as the new act on public finance being in effect since 1 January.

Poland, making efforts for membership of the European Union, was obliged to implement the internal audit as the indispensable tool for the adequate operation of the entire system of the financial management and control in the state [Chojna--Duch 2004, p. 40]. Our country's acceptance of the legislation in the field of financial monitoring common to all EU states, as well as internal audit was supposed to influence the improvement in the effectiveness and transparencies in the execution of the civil service functions, guarantee better public financial resources utilization, also those of EU funds, contributing to consolidation in management of public funds in the whole of society, as well as the resourceful handling of the public financial means and principles of wise stewarding of granted funds [*Raport Rady Ministrów*... 2002]. The

accession of Poland to the European Union opened, especially for self-government entities, new development potentials, making them all at the same time the main beneficiaries of the EU funds. Therefore, a due implementation of both the control system and the internal audit became so important in these self-government entities, constituting the condition of efficiency improvement and the quality of management of public means. In this process, the European Union aims at increasing the certainty that money transferred to self-government bodies will be rationally disbursed in accordance with its intended objectives.

The act on public finance, which came into effect on 1 January 2010, implemented the sequence of new regulations, influencing the internal audit execution in units of the sector of public finance, including self-government entities. The article handles fundamental issues concerning premise of the internal audit introduction and its place in the public sector, its essence, purposes and the scope of performance, as well as the requirements and procedure of its implementation in units of the public finance sector. All the important changes put into practice by the act on public finance were taken into account, all of which result from the practice of applying current regulation in the field of the internal audit. Moreover, the purpose of the article is to make an attempt to verify and analyse the number of self-government entities obliged to carry out the internal audit, in which *de facto* it is functional, how it is organised with respect to the assumed implementations of objectives and methodologies of its performance, what the actions taken by internal auditors in self-government entities are, i.e. types of audit tasks, areas most often and most rarely subjected to the audit, including audit tasks led in the area of activities associated with the disposal of financial resources coming from the European Union.

2. Premise of the introduction and the place of the internal audit in the public sector

The word "audit" is derived from Latin *audire* – to listen, to examine, to interview, to consider [Kuc 2002, p. 71]. It came into existence in the times of ancient Rome and it meant "a listener of accounts"[1]. The modern internal audit was initiated in industrial enterprises after World War II. At first, it was aimed at cases associated with finances and bookkeeping; only later it started to include the whole set of issues associated with running organization and providing assurance and advisory services. A change in direction of the audit took place from accounting and bookkeeping to business-managerial, which with time passing started to penetrate both private entities and structures of the public administration.

[1] Since 4th cent. BC in Rome, there was a job of the clerk, named *auditus* (listener of accounts), whose task was an oral vetting of commercial documents. At that time they started distinguishing the accountant (*quaestors*) from the controller (*auditus*). See Piaszczyk [2003, p. 19].

The internal audit implementation into Polish law order resulted, which was mentioned in the introduction, from the necessity of meeting negotiation obligations by our state with the European Union, which were carried out as part of chapter 28 – "Financial supervision". The European Union attaches great significance to the due constitution and formation of the public internal financial control system, including financial management, control and the independent internal audit in public service organisations. The EU regards the control system to be the basic tool for protection of financial interests of individual member states, as well as the Community as a whole, above all in disciplining authorities in charge and streamlining public expenditures, caring for the correct use of financial means of the Community budgets, including the structural funds and the Cohesion Fund, as well as counteracting misappropriations of funds[2].

Negotiations commenced on 6 April and were already closed on 14 June 2000, and the Polish government committed itself for completing all legal regulation issues of the internal financial control and the internal audit until the end of 2002, which it completed issuing the act on 27 July 2001[3] amending the act of 26 November 1998 about public finance[4]. Appropriately amended regulations corresponding to the internal audit implementation were subsequently introduced one after the other: the act issued on 30 June 2005 about public finance[5], the amending act of 8 December 2006[6], and the current act on public finances issued on 27 August 2009[7].

There is no specific model of the audit which is applicable to all member states of the European Union. There are diverse models of audit and the public control, with different principles and procedures determining various inspections and audit authorities, as well as duties[8]. The multitude of solutions in this respect contributed

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[2] The protection of the financial interests of the Union and individual member states is carried out on the basis of Art. 280 of Treaty establishing the Community. It implements defined principles of the management of financial measures of budgets of the Union, including among others the principle of common action of states to protect financial interests of the EU and the principle of the assimilation obliging member states to fight against all acts affecting financial interests of the Community in the same step, in which they are fighting acts infringing their financial self-interests. See [Chojna-Duch 2004, p. 43; Chojna-Duch 2010, p. 52].

[3] Act issued on 27 July 2001 about the amendment to the act on the public finance, acts about the organization and the mode of the ministry and about the scope of action of ministers, acts on government administration division and acts on the civil service (Journal of Laws No. 102, pos. 1116).

[4] Act issued on 26 November 1998 about public finance (Journal of Laws from 2003 No. 15, as amended pos. 148).

[5] Act issued on 30 June 2005 about public finance (Journal of Laws from 2005 No. 249, as amended pos. 2104).

[6] Act issued on 8 December 2006 about the amendment to the act on the public finance and some other acts (Journal of Laws No. 249, pos. 1832).

[7] Act issued on 27 August 2009 about public finance (Journal of Laws from 2009 No. 157, as amended pos. 1240).

[8] It is possible to single out two fundamental models of the audit and the public control: southern and northern. In the southern model (e.g. France) the internal audit is identified with control, here a typical system of the internal audit does not exist. In the northern model (e.g. Great Britain, Germany)

to the creation of international standards in the field of control and the internal audit. As the most significant is considered *International Standards of the Professional Practice of the Internal Audit*, which was drawn up by the American Institute of the Internal Audit (*The Institute of Internal Auditors*). In compliance with the act on the public finance the institute guidelines were accepted as standards of the internal audit being in effect in units of the sector of the public finance in Poland[9].

Internal audit is an institution of a management system in the public sector, supporting this structure. It is considered to be the part of internal control (managerial one) in the public service units [Jędrzejewski 2005, p. 366], but it involves a broader meaning than check and inspection only [Winiarska 2009, p. 445; Jagielski 1999, pp. 2-3]. Internal audit, besides the function attributed to inspections (checking and evaluating), includes also the sequence of operations related to an advisory and assisting character, designed to support the unit directors in their tasks of public finance sector performance which are entrusted to them. The independent, professional and objective internal audit is an essential source of information for the manager about the subordinate public service unit and the instrument of the management serving for the rational assurance of appointed objectives (strategic and operational), implementation and adherence to principles and procedures resulting from legal regulations and effective for the correct action of the individual mechanisms, as well as procedures constituting the internal control system (managerial) [*Podręcznik audytu*… 2003, p. 5].

The internal audit is closely connected with managerial control in self-government entities, which according to article 68 of the act applying to public finance, constitutes a whole range of activities undertaken to guarantee the achievement of the goals and tasks of the self-government entity, being law abiding, effective, economical and timely. The manager responsible for the implementation of the system of managerial control is supported by the auditor, whose duty is to provide an assessment of the effectiveness and efficiency of such a control. As a result, the auditor advises the self-government entity manager about the managerial control system operation, whose purpose is to provide the compatibility of self-government entity activities with the law and internal procedures, effectiveness and efficiency of action, credibility of reports, protection of stores, promotion and adherence to principles of ethical proceedings, and the effectiveness and efficiency of data flow and risk management.

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the internal audit is clearly distinguishable, and in its essence there is assessment making and systems analysis of possible improvements in the existing control system for the established purposes of the management. As such, the latter model meets international standards of the internal audit. See [Smolak 2003].

[9] Announcement No. 8 of the Minister of Finance issued on 20 April 2010 in the matter of standards of the internal audit in units of the sector of the public finance (Official Journal MF No. 5, pos. 24).

3. Essence, basic objectives and scope of the internal audit

The essence of the internal audit is accurately formulated by the American Institute of Internal Auditors (IIA). The internal audit is an independent, objective activity of assuring and advisory character, performed with a view to bringing some added value into the organization and its streamlining function. The internal audit is meant to support an organization in achieving determined purposes through systematic and consistent actions serving the evaluation and efficiency improvement in risk management, control systems and organization management processes [Czerwiński 2004, p. 9]. The very specified and precise definition of the internal audit can be found in *International Standards of the Professional Practice of the Internal Audit*, which specifies understanding of notions: "assurance" and "consulting" [Anczakowski 2006, pp. 29-30][10].

The concept and notion of the internal audit surrendered to the gradual evolution in subsequent acts on public finance[11], steadily approaching the definition and standards of the internal audit accepted by the Institute of Internal Auditors[12]. Acts of law at present being in effect in Poland on public finance issued on 27 August 2009 determine that the internal audit is an independent and objective activity, whose purpose is to support the manager of the unit of the sector of public finance in the accomplishment of its purposes and tasks through the systematic evaluation of the managerial control, in particular the evaluation concerning the adequacy, effectiveness and efficiency of the managerial control and advisory activities (art. 272, sec. 1 and 2). The appropriate audit of management in self-government entities, which is supposed to be the very basis of the effective internal audit, not only requires the evaluation of financial transactions of the given public service unit, but also tests and the supervision of the whole management processes and control systems, including decision making and the assessment of the system in addition to the managerial control operation in the self-government entity. Advisory activities of the internal auditor also include proposals (rather than up till now recommendations) presented to the entity manager, aimed at streamlining the unit operational functions [Chojna-Duch 2010, p. 53].

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[10] See also: *The manual on the internal audit in the civil service*, the Ministry of Finance, Warsaw 2003, p. 6, *International Standards of the Professional Practice of the Internal Audit*, www.iia.org.pl and *Principles of performing advisory activity through internal auditors* [in:] *Practice Advisories*, document drawn up by the Institute of Internal Auditors (IIA) for the purposes of the Chief Inspector of the Internal Audit, www.mf.gov.pl.

[11] See art. 35c, sec. 1 act issued on 26 November 1998 about public finance, art. 48 sec. 1 and 2 acts issued on 30th June 2005 about public finance and art. 272 sec. 1 and 2 acts issued on 27 August 2009 about the public finance.

[12] *International Standards of the Professional Practice of the Internal Audit* drawn up by The Institute of Internal Auditors, translated into Polish and accepted by the Minister of Finance as applying to standards of the internal audit in units of the sector of public finance in Poland.

The internal audit certifies management system of the unit, which should give the rational certainty of its correct functioning. Among the numerous aims of an internal audit, there are several priorities of utmost importance:

- delivering rational assurance to the unit manager through independent and objective assessment of the management and control system functioning in the self-government entity that these systems work correctly (guaranteeing such activities has primary importance);
- adding to the value and streamlining functions of the self-government entities through advisory activities (these activities can be performed, providing that their purpose and scope do not disturb the principle of the objectivity and the independence of the internal auditor);
- detection (identification) and estimation (analysis) of potential risk which is likely to appear as a part of activity of the unit along with the examination and the evaluation of the adequacy, effectiveness and efficiency of internal control systems (managerial) and of risk management, which are aimed at the elimination or reduction of such a risk;
- filing a report from findings and, where it is appropriate, presenting remarks and suggestions concerning the improvement in the efficiency of action of the self-government entities in a given area [Komunikat 16/2006; *Podręcznik audytu*… 2003, p. 7].

The internal audit includes within its own scope all areas of action of the self-government entity, especially an examination and the evaluation of the adequacy, effectiveness and efficiency of the internal control system (managerial), risk management and the unit performance. In particular, these range of activities means:

- a review of established mechanisms of the internal control and their credibility, as well as the accuracy supervision of operational, managerial and financial information;
- an evaluation of procedures and the practice of drawing up, classifying and presenting the financial information;
- an evaluation of the legal adherence, internal regulations of the unit and programs, the strategy and standards established by relevant authorities;
- an evaluation of possessions and property protection of the self-government organization;
- an evaluation of the effectiveness and economy of the use of the entity resources;
- an inspection of programs and projects with a view to establishing the compliance of the entity operations with intended results and objectives;
- an evaluation of the entity activity adjustment to previously introduced recommendations of the audit or control [*Podręcznik audytu*… 2003, p. 8].

Having examined the object scope of the internal audit in entities of the public sector, it is possible to distinguish its three basic kinds: finance, system, and activity. The financial audit handles studying bookkeeping vouchers and bookkeeping entries.

It also concerns an evaluation of financial statements and budget implementation reports according to standards of the financial review. The audit of the system guarantees the assessment of the arrangement of public means collection and their disposal, as well as the management of the public property. The audit of activity makes an assessment of the effectiveness and economy of the financial management and control, as well as a compliance of activities performed with the law and internal procedures applied in the entity. It includes the assessment of effectiveness, efficiency and impacts of economic events on the unit performance in particular (see Figure 1) [Kostur (ed.) 2007, p. 53; Kuc 2002, pp. 107-108; *Podręcznik audytu*… 2003, p. 7].

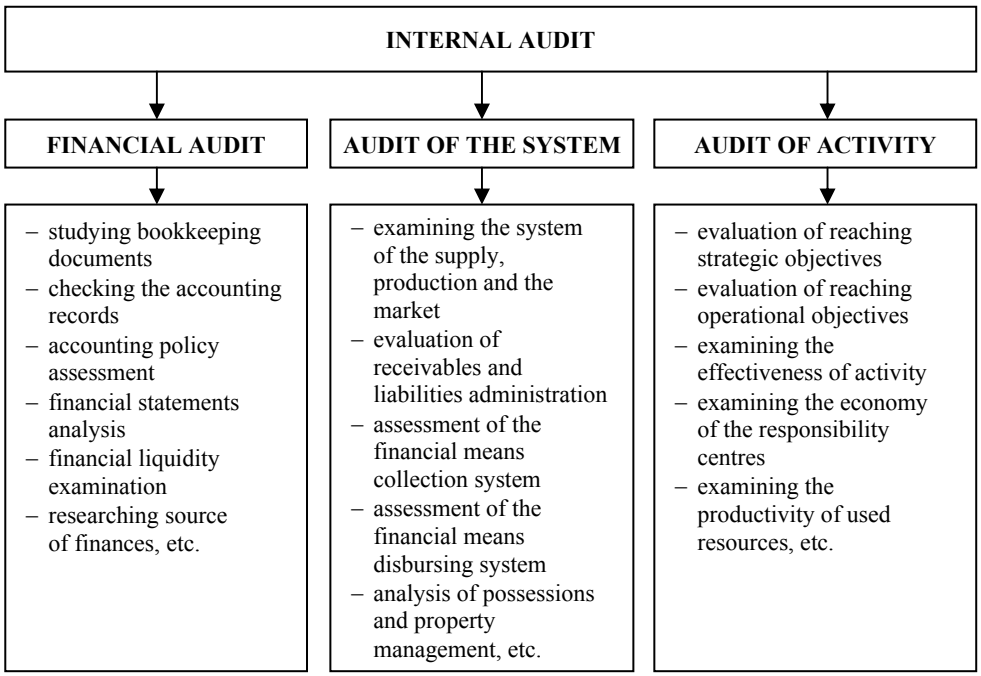

Figure 1. Object scope of the internal audit

Source: [Winiarska 2005, p. 33].

In Poland, considering the practical dimension of the internal audit execution in the public sector, auditing activities should be especially focused on management processes and the internal control (managerial), document circulation, management of possessions and property, computer data safety, appropriate personnel policy, as well as abiding by the Accounting Act and procedures for granting public procurement.

4. Requirements and the procedure of the internal audit performance in self-government entities

Primary requirements within the scope of the internal audit execution and the principle of activity of auditors in the local self-government authority units in the public finance sector (including self-government entities) are determined by art. 272–296 of the new act on public finance. However, the detailed way and the mode of conducting the internal audit (procedure of the internal audit conduct) is regulated by the directive of the Minister of Finance[13].

The duty of the internal audit implementation in local self-government authority units results from art. 274 sec. 3 acts on public finance[14]. All self-government entities whose amount included in the budget resolution of profits and incomes or amount of expenditure exceeded 40 million zloty have been obliged to perform the audit. This simply indicates that if an amount of public means being in disposal of the local self-government entity exceeds the amount of 40 million zloty, the manager the of the self-government entity has a duty to launch the internal audit – by the end of the third quarter of the following year after the year in which this condition was met. Of course, the internal audit can be conducted also in any other self-government entity at all levels of the state administration but such a procedure depends on the decision of the manager of a particular entity (art. 274 sec. 4).

In compliance with art. 275, the internal audit can be led by the employed internal auditor in the self-government entity or a non-associate contractor (external subject). The internal audit can be run by the contractor if the self-government entity included in the budget resolution involves the amount of profits and income and the amount of expenditure lower than the 100 million zloty (art. 278 sec. 3). A private person can be a contractor, as well as any economy partnership including the operating, open, partner, limited, limited joint-stock and civil law one or legal person. Each of the listed subjects must meet definite conditions specified in art. 286 acts on public finance (art. 286 indicating what subjects qualify to be an internal auditor) or employ individuals matching the requirements. Moreover, the agreement concluded with the contractor should contain decisions guaranteeing the execution of the internal audit according to regulations of the act on public finance. In the agreement one should

[13] Regulation of the Minister of Finance issued on 1 February 2010 concerning internal audit conduct and documentation (Journal of Laws from 2010 No. 21, pos. 108) determines in particular: (1) the way of drawing up and elements of the annual plan of the internal audit, (2) the way of audit course documentation and its conclusions documentation, (3) the way of drawing up and elements of conclusions of the internal audit, (4) the way of drawing up and elements of the report on the plan of the audit execution, (5) mode of conducting the commissioned internal audit, (6) mode of conducting the evaluation of the internal audit performance.

[14] Before the coming into force of the act issued on 27 August 2009 about public finance, these matters were regulated by the directive of the Minister of Finance issued on 24 June 2006 in the matter regulating amounts of money which being exceeded trigger the duty of the internal audit performance in units of the sector of public finance (Journal of Laws from 2006 No. 112, pos. 763).

also determine the manner of documents handling, also with those in an electronic form, generated for the purpose of the internal audit performance in order to provide their availability, protection against their unauthorized spreading, damage or destruction. The self-government entity concludes such an agreement with the contractor for the period of one year minimum (art. 279).

Internal audit in the self-government entity is carried out in the internal audit section, which is created at the office of the self-government entity (art. 277 sec. 1). In compliance with art. 280, the internal auditor (a chief of the audit section) reports directly to the manager of the appropriate self-government entity (i.e. to the commune administrator, to the mayor, to the president of the city, to the chairman of the Management Board of the local self-government authority). For the organization of the internal audit in an entity the manager of a given self-government entity provides conditions necessary for an independent, objective and effective performance of the internal audit, as well as taking responsibility for the organizational independence of the internal audit section and the continuity of its execution in the self-government entity (art. 282 sec.1). The manager of the self-government entity also ultimately authorizes the internal auditor, employed in the office of a given self-government entity, to carry out the internal audit scheme both in the entity and its other organizational structural departments (art. 287 sec. 1). The internal auditor has the right of unlimited admission into rooms of the entity and permission for free access to all documents along with information and data associated with the operation and organization of the self-government entity, as well as to producing their copies, excerpts, balance sheets or printouts, in compliance with regulations of the secrets protected by law (art. 282 sec. 2).

The auditors cannot be exposed to any attempts of influence by other self-government entity associates in the areas of the audit or affected in any way in their performance of work and the transmission of audit results. Performing their duties, auditors must be independent, objective and impartial. The internal auditor cannot also participate in the operational activity of the self-government entity, since it would be an obstacle to due task execution in the case of a given individual. The chosen auditor should perform all duties with due diligence and in a professional way passing available information about the results of the audit tasks to the manager of the entity [Komarnicka 2006, p. 297]. The manager of the self-government entity is obliged, in accordance with art. 274 sec. 7 acts on the public finance to inform in a written form the Minister of Finance of the internal audit initiation in the specific unit. However, the auditor does not have to present to the Minister of Finance the information about the completion of the internal audit task in the self-government entity in the previous year (art. 195 sec. 1), similarly no other information and documents associated with the internal audit in the self-government entity must be presented to the minister (art. 296).

The internal auditor in the local self-government entity, carrying out the internal audit, follows guidelines included in standards of the internal audit (art. 273 sec. 2).

They were approved by the Minister of Finance in an announcement issued on 20 April 2010 on the matter of standards of the internal audit in units of the sector of public finance and they match "universally acknowledged standards of the internal audit"[15]. The purpose of the standards is to provide the appropriate quality and the uniform way of the internal audit execution in all self-government entities through determining basic rules of the arrangement of the internal audit, requirements concerning practicing the profession of the auditor, as well as criteria and manners of the audit evaluation [Komarnicka 2006, p. 296].

The supplementing documents to the standards are the *Code of ethics of the internal auditor in units of the sector of the public finance* and the *Charter of the internal audit in units of the sector of the public finance*, whose guidelines constitute the internal audit functioning in Poland [Komunikat 16/2006; *Podręcznik audytu*… 2003, p. 7]. *Code of ethics of the internal auditor* includes principles referring to the practice of the internal audit execution and the code of conduct and manner expected from the internal auditor. These rules are of help in the practical application of the principles and their purpose is to indicate patterns of the ethical conduct of the internal auditor. Similarly, the *Charter of the internal audit* constitutes the recommended pattern for internal regulations concerning the internal audit execution and detailed principles of the audit conduct in the units of the sector of public finance (including self-government entities); namely, which particular units should implement and adapt to their specific tasks and conditions in which they function. Based on the documents mentioned, the internal auditor draws up principles of the arrangement, detailed goals, the scope and procedures of the internal audit, which should be settled with the self-government entity manager in a written form and ought to include in particular specific legal, organizational, personnel background, as well as the financial activities of a given self-government entity.

The audit is run on the basis of the annual plan of the internal audit (art. 283 sec. 1), based on the risk analysis and including audit tasks for carrying them out in a given year, topics and proposed schedule of their accomplishment, as well as areas of risk which should be in plans of the audit in the self-government entity in the next years. The areas of risk analysis with the range of the self-government entity activity have first-rate significance in audit plan creation and the execution of audit tasks [Czerwiński 2003, p. 11]. The analysis constitute a starting point for further action taken by the auditor, i.e. drawing up the relevant plan of the internal audit and then working out the detailed program of every audit task, which in its content include the aim of the audit, analysis of areas of risk, the subject and object scope of the task, as well as methods and techniques utilized in the process [Komarnicka 2006, p. 297].

A risk is a probability of an event appearance, action or omissions of which there can be an effect of damage in the wealth or image of the local authority or which can

[15] See footnotes 13 and 20.

disturb achieving expected objectives and tasks. These events can appear both in the external environment of the self-government entity, they can result as well from its activity, e.g. the imperfections of organizational structure or the flow of information in the self-government entity. The auditor's task is to make an assessment of the degree of importance and arrange the sequence of risk area subjected to internal audit from the point of view of achievement of the goals and objectives of the self-government entity. Making decisions in this respect, the auditor must take into account not only the possible threats incurred as a result of improper arrangements and performance of management processes and the managerial control in the entity, but also the threats associated with the failure in utilization of certain abilities or opportunities, like for example a failure in taking advantage of available means as a part of the union programs. In the plan of the audit there should be included: a sequence of risk area subjected to the internal audit and organizational factors, particularly the time essential to the conduct of audit tasks, available human resources and material, as well as costs of the internal audit execution [Jędrzejewski 2005, p. 371]. The plan of the internal audit for the next year is prepared by the internal auditor with the approval of the manager of the self-government entity by the end of the year. Before the end of January, the internal auditor is also supposed to draw up a report on the audit plan execution for the previous year, informing the manager of the self-government entity about the degree of the implementation of the audit plan and substantial risks and weaknesses of managerial control (art. 283, sec. 3 and 5). The plan of the audit and the report on the audit plan realization, on the basis of art. 284 acts on the public finance is subject to public information, and made available on demand[16].

The detailed procedure of conducting the internal audit and documenting it, as well as the manner of drawing it up and all elements of audit output, as mentioned earlier, is regulated by the directive of the Minister of Finance[17]. Ultimately, the report on the audit conducted finds its way to the self-government entity manager, who makes an assessment of its usefulness on the basis of the regulations included in the report concerning arrangements of the actual state, among others of the audited sections, indications of the weaknesses in managerial control and analysis of their causes, effects and the risk resulting from the indicated weaknesses of the managerial control, recommendations for failure elimination and introduction of streamlining strategy, as well as the auditor's opinion on the effectiveness of management in the audited section. Considering the report results, the manager of the self-government entity takes action aimed at identified shortcomings elimination or performance streamlining of the entity, informing the auditor about it. The internal auditor can

[16] As defined in the act issued on 6 September 2001 about access to public information (Journal of Laws from 2001 No. 112, as amended pos. 1198).

[17] Regulation of the Minister of Finance issued on 1 February 2010 concerning internal audit conduct and documentation (Journal of Laws from 2010 No. 21, pos. 108).

also conduct checking activities, making an appraisal of the adaptation of the self-government entity's action to meet reported recommendations.

In line with *International Standards of Professional Practice of the Internal Audit* the internal audit should be surrendered, from the point of view of assurance and improvement in its quality, to both external and internal evaluation. The external evaluation must be carried out at least once a five-year period by an independent person or committee of experts not associated with the organization. The internal evaluation should include a current overview of audit operation effected by the manager, as well as a periodic review (e.g. once a year) practice conducted through the self-assessment approach or, by another individual as a part of the organization which has sufficient knowledge within the range of the scope of the internal audit. For running such a self-check, one can find helpful *Guidelines to the self-assessment of the internal audit in the unit of the sector of the public finance* drawn up by the Department of the Financial Control Co-ordination and Internal Audit of the Ministry of Finance[18].

The duty of the internal auditor, on the basis of art. 286, sec.1 act about public finance, can be performed by a person who: (1) has citizenship of an EU member state or other state, of which citizens, on the basis of international agreements or community law provisions, are entitled to the right to be employed on the territory of the Republic of Poland, (2) has the full capacity to act in law, as well as enjoys full civil and political rights, (3) has not been punished for an intentional felony or deliberate fiscal offense, (4) has higher education, (5) has qualifications for conducting the internal audit confirmed by one of the international certificates listed in the act or sat an examination with a positive result to the internal auditor before the Examination Board appointed by the Minister of Finance, or has authority of the statutory auditor, or has a two-year practice in the internal audit and has a diploma of post-graduate education completion in the internal audit issued by the authority entitled to grant a university degree title of doctor of economics or legal studies (Ph.D.). Moreover, regulatory acts constitute the kinds of activity performances and the length of time that can be recognized as practice in the internal audit (art. 286 sec. 2).

5. Practical dimension of the internal audit functioning in the self-government sector

The results and findings of the research carried out by the Audit Sector Department of the Public Finance in the Ministry of Finance in 2008 brings a lot of interesting information for the internal audit operation in self-government entities in Poland [*Audyt wewnętrzny*… 2007]. They are particularly noteworthy since with each year passing, the number of self-government entities obliged to conduct the internal audit

[18] At present, it is the Audit Sector Department of the Public Finance in the Ministry of Finance, comp. website of the Ministry of Finance: www.mf.gov.pl.

is rising. In 2004, when Poland acceded to the European Union, there were over 400 self-government entities obliged to launch an internal audit, in 2005 and 2006 there were as many as over 500, in 2007 – 621, in 2008 – 684 and in 2009 – 776[19]. The survey method research was done amongst the self-government entities obliged to submit the internal audit in 2007.

5.1. Subject and object scope examinations

In 2007 there were 621 self-government entities obliged to conduct the internal audit, which constituted 22% of all self-government units. In the division for self-government units of each public administration level, there were: 16 voivodeship (*województwo*), 65 cities on laws of the district (*miasto na prawach powiatu*), 209 districts (*powiat*) and 331 communes (*gmina*). Out of all self-government entities obliged to conduct the internal audit, voivodeships constitute 3%, districts 34%, cities on laws of district 10%, whereas communes 53%.

Table 1. Subject scope of the questionnaire survey

	Location of the audit section	Total number of self-government entities	Number of self-government entities obliged to conduct the audit in 2007	Number of self-government entities which sent questionnaire forms	Number of self-government entities which according to questionnaire forms carry out the internal audit (basis of an analysis)
All self-government entities		2873	621	339	275
Voivodeships	marshall office	16	16	16	16
Cities on laws of the district	municipal office	65	65	47	47
Districts	district office	314	209	99	77
Communes	the municipal office, the municipal office and communes, commune office	2478	331	177	135

Source: [*Audyt wewnętrzny*… 2007].

From the point of view of the internal audit operation in self-government entities some key areas underwent an examination, i.e.:

1) the way of the internal audit section arrangement and the auditor subordination to the manager of the self-government entities;

[19] Report concerning the internal audit in the public sector in years 2005-2010 drawn up by the Audit Sector Department of the Public Finance in the Ministry of Finance, www.mf.gov.pl.

2) drawing up certain documents determining: targets, scope and authority of the internal audit, as well as the auditing methodology, principles and the code of conduct of the internal auditor;

3) preparation of a long-term operational plan of the audit spreading through all areas of action of the self-government entity;

4) conducting the external evaluation and self-assessments of the internal audit;

5) action conducted by internal auditors – types of audit tasks and audited areas;

6) audit tasks performed in the area of activity associated with the European Union funds disposal;

7) issues and areas most often and most rarely subjected to the audit.

5.2. The way of the internal audit section arrangement and the auditor subordination to the manager of the self-government entities

An internal audit at the offices of self-government entities is arranged in the form of the separate organizational section in 236 self-government entities (analysis covered 86% entities), which indicates, in breaking it down for individual local authority, that the audit is run in 13 voivodeships (81% voivodeships provided analysis), 69 districts (90% districts provided analysis), 40 cities on laws of the district (85% cities on laws of the district provided analysis) and 114 communes (of 84% communes provided analysis). In the 39 remaining self-government entities (which is 14% entities providing analysis) the internal audit is led in combination with the reviewing section. Such a situation takes place in 3 voivodeships (19% of all voivodeships provided analysis), 8 districts (10% districts provided analysis), 7 cities on laws of the district (15% cities on laws of the district provided analysis) and 21 communes (16% communes provided analysis).

As a general rule in most offices of self-government entities, the internal auditor (the manager of the internal audit section) reports directly to the manager of the self-government entity. Such a situation takes place in all marshal offices where the auditor reports directly to the voivodeship marshal (100% voivodeships), at district offices – to the district administrator of the district (100% districts), at municipal offices – to the president of the city (98% cities on laws of the district) or to the secretary (2% cities on laws of the district); however, in the instances of communes – appropriately to the president of the city (20% communes), to the mayor (73% communes), to the commune administrator (6% communes) and to the treasurer (1% communes). The case of inappropriate positioning of the office of the auditor in the organizational structure of self-government entity (the manager of the internal audit section) appears scarcely in 2% of examined data from cities on laws of the district (where the internal auditor reports to the secretary) and in 1% of analysed information coming from communes (where the internal auditor reports to the treasurer).

5.3. Drawing up documents determining targets, scope and authority of the internal audit, as well as the auditing methodology, principles and code of conduct of the internal auditor

Following the guidelines of *International Standards of Professional Practice of the Internal Audit*, the documents including targets, the scope and authority of the internal audit in the form of the *Charter of the Internal Audit* or *Regulations of the Internal Audit* were formally determined in 88% of all analysed self-government entities, i.e. in 14 voivodeships (which is 88% of marshal offices), in 70 districts (which is 91% of analysed district offices), in 38 cities on laws of the district (which constitutes 81% of examined municipal offices on laws of the district) and in 120 communes (which constitutes 89% of analysed commune offices).

The document determining methodology (procedure) of the internal audit conduct in the form of the *Manual of procedures of the internal audit* was drawn up in 48% of the analysed self-government entities. Such a situation appeared in 14 voivodeships (which constitutes 88% of marshal offices), in 32 districts (which constitutes 42% of analysed district offices), in 27 cities on laws of the district (which is 57% of examined cities on laws of the district) and in 59 communes (which constitutes 44% of examined offices of communes). One should point out that the document determining the methodology of the internal audit conduct should be set in those self-government entities in which the internal audit is carried out by at least a two-man committee. Bearing in mind the fact that in over 90% of the analysed self-government entities there is a single person internal audit section, one should appreciate the number of self-government entities in which *Procedures of the internal audit* has been determined.

The principles and the code of conduct of the internal auditor were determined in the form of the *Code of ethics of the internal audit* in 26 self-government entities (which constitutes merely 9% of all analysed offices) and is used: in voivodeships – at 3 marshal offices (19% of analysed marshal offices), in districts – at 11 district offices (14% of analysed district offices), in cities on laws of the district – at 7 offices of cities on laws of the district (15% of analysed offices on laws of the district) and in communes – at 5 commune offices (4% of the analysed commune offices).

5.4. Preparation of a long-term operational plan of the audit spreading through all areas of action in the self-government entity

According to the *Charter of the internal audit in units of the sector of the public finance* the internal auditor (the manager of the internal audit section) is responsible for making a long-term (strategic) plan of the audit spreading through all areas of the self-government entity activities. Such a scheme should be made on the grounds of a risk analysis outcome. The long-term (strategic) plan of the internal audit has been drawn up in 108 self-government entities conducting the internal audit (which is

39% analysed offices), among them: 6 voivodeships (38% analysed voivodeships), 29 districts (38% analysed districts), 19 cities on laws of the district (40% analysed cities on laws of the district) and 54 communes (40% analysed communes).

5.5. Conducting the external evaluation and self-assessments of the internal audit

In concordance with *International Standards of Professional Practice of the Internal Audit,* the internal audit should be subjected to both external and internal evaluation. External evaluations should be made at least once in five years by a qualified person or a committee from outside the organization. In 2007 the efficiency of the internal audit section was subject to external evaluation in 38 self-government entities (which constitutes in total 14% of all analysed self-government entities), where 62 external evaluations were conducted. Among those self-government entities there were: 6 marshal offices (38% analysed voivodeships), 7 district offices (9% analysed districts), 9 municipal offices (19% analysed cities on laws of the district) and 16 commune offices (12% analysed, urban-rural and country urban communes). However, on the basis of the submitted questionnaire forms it was not possible to establish explicitly the scope of external evaluations, because they were built by all sorts of bodies (e.g. external ISO auditors, voivodeships offices, Government Inspectorate, regional account chambers), and therefore the criteria of these evaluations were largely inconsistent.

The internal evaluation should include the current activity evaluation of the internal audit and periodic overviews conducted through the self-assessment method or by another person from the organization having enough experience within the scope of the internal audit. The documented self-assessment of the internal audit section operation was made in 92 self-government entities (which constitutes 33% of analysed units) encompassing: 5 marshal offices (which constitutes 31% of analysed voivodeships), 22 district offices (which is 29% of analysed districts), 15 municipal offices (which constitutes 32% of analysed cities on laws of the district) and in 50 communes (which is 37% of the analysed communes).

5.6. Action conducted by internal auditors – types of audit tasks and audited areas

An internal audit in self-government authority entities includes tasks of both an assuring, and advisory character. In all the examined self-government entities in 2007 there were 1059 audit tasks conducted, including 883 tasks of an assuring character (which constitutes 83% of all tasks conducted by analysed self-government entities) and 176 tasks of advisory character (which constitutes 17% of all the tasks). In breaking down individual self-government entities, the statistics shows the following proportions: in voivodeships – 130 tasks (which constitutes 12% of all conducted

tasks), in districts – 300 tasks (which constitutes 28% of all conducted tasks), in cities on laws of the district – 208 tasks (which constitutes 20% of all conducted tasks) and in communes – 421 tasks (which constitutes 40% of all conducted tasks).

The audit tasks were conducted in 257 self-government entities in total (which constitutes 93% of examined self-government entities i.e. 16 marshal offices (100% analysed marshal offices), 71 district offices (which constitutes 92% of analysed district offices), 46 municipal offices (which constitutes 98% analysed municipal offices) and 124 offices of communes (which constitutes 92% of examined offices of communes). In 18 self-government entities (7% analysed self-government entities) no audit tasks were conducted in 2007, in spite of their claiming that the internal audit was executed there.

As far as the structure of the audit tasks is considered, amongst 257 self-government entities which conducted the audit tasks, 183 self-government entities performed audit tasks of only an assuring character (67% analysed self-government entities), 65 local authority performed tasks of assuring and advisory character (24% analysed individuals), whereas 9 self-government entities conducted only advisory tasks (3% analysed self-government entities).

Amongst those mentioned earlier, 130 audit tasks conducted at marshal offices – 104 assignments regarded tasks of an assuring character (which constitutes 80% tasks conducted in voivodeships) and 26 referred to tasks of an advisory character (which constitutes 20% tasks conducted in voivodeships). Amongst 300 audit tasks conducted in district offices – 245 regarded activities of an assuring character (which constitutes 82% tasks conducted in districts) and 55 were connected with objectives of an advisory character (which constitutes 18% tasks conducted in districts). Amongst 208 audit tasks conducted in cities on laws of the district – 171 concerned tasks of an assuring character (which constitutes 82% of tasks conducted in cities on laws of the district) and 37 was associated with objectives of an advisory character (which constitutes 18% tasks conducted in cities on laws of the district constitute). Finally, amongst 421 audit tasks conducted in communes – 363 concerned objectives of an assuring character (which constitutes 86% tasks conducted in communes) and 58 involved tasks of an advisory character (which constitutes 14% tasks conducted in communes).

5.7. Audit tasks led in the area of activity associated with European Union funds disposal

The internal auditor is authorized to audit all areas of the self-government entities activity, including the area of performance connected with union funds disposal . This area is particularly essential from the prospect of obtaining EU funds to self-government entity development and their due disbursing, which is the European Union's strong point of emphasis.

In 108 self-government entities (39% analysed self-government entities) internal auditors examined the area of activity associated with funds management that come

from the EU (which constitutes 10% of all 1059 completed audit objectives). In this area audit tasks were conducted in all voivodeships, in 25 districts (33% analysed districts), 34 cities on laws of the district (72% analysed cities on laws of the district) and 33 communes (of 24% analysed communes).

5.8. Areas most often and most rarely subjected to internal audit

Amongst all the audit tasks conducted in the self-government entities, the most often audited areas were: financial management (35%), management (31%) and purchasing, including public procurement (12%). However, the most rarely audited areas in self-government entities are computer systems (4%), safety (8%) and possessions and property administration (11%). What does the structure of audited areas look like in the division for individual self-government entities?

In voivodeships, the most often audited areas concern management, safety and financial management (87% of all tasks conducted in voivodeships), whereas computer systems have been most rarely audited, purchases (including public procurement) and possessions administration (13% of all the audit tasks conducted in voivodeships).

In districts, these are the most often audited areas: financial management, management and purchases, including public procurement (82% of all the audit tasks conducted in districts); however, computer systems, safety, possessions and property administration have been most rarely subjected to the audit (18% of all the audit tasks conducted in districts).

In cities on laws of the district the most often audited areas concern management, financial management, possessions and property administration (82% of all the audit tasks conducted in cities on laws of the district), while the most rarely subjected areas to the audit were computer systems, safety and purchases, including public procurement (18% of all the audit tasks conducted in all cities on laws of the district).

In communes, however, these are the most often audited areas: financial management, management, possessions and property administration (77% of all the tasks conducted in communes), whereas computer systems, safety and purchase including public procurement have been audited most rarely (23% of all the audit tasks conducted in communes).

6. Final consideration

Internal audit constitutes a modern instrument of management, which brings new quality into the management system of public means in units of the public finance sector, including self-government entities. From a perspective of nine years of internal audit operation in the public sector, it is possible to state objectively that it found its permanent place in self-government entities, which by law are obligated to execute it, as the tool enabling the optimization of financial management, delivering

knowledge about the effectiveness and efficiency of the managerial control system adopted in self-government entities, allowing for establishing rational procedures, based on regulations of proceedings, and the timely completion of appointed objectives.

The results of the Ministry of Finance's review indicate that in the great majority, the manner of the organization of the internal audit sections at the offices of self-government entities, as well as the auditor's subordination to managers of self-government entities, are satisfying and the organizational identity of the internal audit is retained. One should appreciate the fact that by and large in self-government entities documents determining purposes, the scope and powers of the internal audit were formally accepted in the form of the charter or regulations of the audit. The situation looked a little worse where documents determining the methodology of the internal audit in the form of the manual of procedures were concerned – they were drawn up by fewer than half of the examined local self-government entities. In few self-government entities principles and a code of conduct of the auditor were drawn up in the form of the code of ethics of the internal auditor, which requires action aimed at acceptance of that kind of document according to *International Standards of Professional Practice of the Internal Audit.* Additionally, the duty of drawing up long-term operational plans of the internal audit is not fulfilled to a satisfying degree either – such a situation takes place in fewer than 40% of the studied self-government entities, whereas running the documented self-assessment of the internal audit section operation took place in as few as 30% of the examined self-government entities.

As far as audit tasks conducted in examined self-government entities are concerned, those of an assuring character prevail (over 80% of all the conducted tasks). This harmonizes with regulations of the *Charter of the internal audit* on the primary importance of activities guaranteeing the internal audit execution in the self-government entities (advisory actions can be made, provided their purpose and the scope do not disturb the principle of the objectivity and the independence of the internal auditor). Audit tasks in the area of activity associated with the disposal of financial means coming from the EU were conducted in fewer then 40% of the examined self-government entities. It seems that self-government bodies should attach greater significance to the appropriate audit execution and effective management of obtained EU funds, as well as their utilization, which constitutes one of the most important factors of local and regional development.

Definitely, the most often audited areas among self-government entities are financial management, management and purchase (including public procurement), which constitutes over 75% of all the conducted audit tasks. However, the areas most rarely subjected to the audit, i.e. computer systems, safety, possessions and property administration in self-government entities require greater attention. Although these areas are not directly connected with the financial management of self-government authority entities, they are equally important forms of activity and they condition the appropriate performance of the self-government entities.

The studies of the questionnaire survey results, especially concerning local self-government authorities (of communes and districts which sent filled in questionnaire forms), should make one notice that in spite of the existing obligation of running the internal audit, *circa* 22% districts did not implement it nor 24% communes. If the number of all communes and districts obliged to conduct the audit (also of the ones which did not send filled in questionnaire forms) is to be taken into consideration, the situation appears even more disadvantageous – as it amounts to 37% districts and 41% communes appropriately. Such a state of affairs can result from the lack of lawful and applicable sanctions for failure in implementation of the internal audit in self-government entities. The introduction into the act of some adequate rules which will further discipline local authority managers in this matter is worth considering

Internal audit, being a new element of assisting the process of managing public resources, in the specific Polish conditions, above all, ensures the protection of the public interest in public funds management and their utilization. Its scope and the role are subject to constant development and its conception, as well as legal and organizational solutions keep evolving and they are being permanently improved. The auditors face new challenges associated with membership of Poland in the European Union structure, which as mentioned earlier, are concerned with the appropriate verification and utilization of funds coming from EU, of which self-government entities are chief disposers. One should remember that the implementation of the internal audit and its appropriate positioning in the managerial control as a part of the system is a necessary condition, but not sufficient enough for satisfying improvements in self-government entities performance. The internal audit should be co-ordinated with other actions (elements of functioning) of self-government entities, which organised in the mode of up-to-date managed companies will create conditions for our country to be perceived as a credible partner and beneficiary of foreign aid.

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AUDYT WEWNĘTRZNY W JEDNOSTKACH SAMORZĄDU TERYTORIALNEGO W POLSCE. PODEJŚCIE TEORETYCZNE I EMPIRYCZNE

Streszczenie: W artykule przedstawiono instrument audytu wewnętrznego, przesłanki jego wprowadzenia, istotę, cele, zakres i miejsce w sektorze finansów publicznych, ze szczególnym uwzględnieniem wymogów i procedury prowadzenia audytu wewnętrznego w jednostkach samorządu terytorialnego w Polsce. Na podstawie przeprowadzonych badań dokonano analizy funkcjonowania audytu wewnętrznego w sektorze samorządowym, z uwzględnieniem najważniejszych jego elementów. W oparciu o wyniki badań sformułowano wnioski końcowe.