

Internal Audit as an Improvement Tool for Public Sector Organizations. Case of Poland

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ABSTRACT

This paper has two purposes. The first one is to show the current situation of the internal audit function as used in the public sector organizations in Poland, and the second, to present an original view on the internal audit system, as an effective tool for this kind of organizations' improvement. Describing the methodology, two aspects of this concept were stressed – functional and operational. Based on our research of the present situation in Poland, it could be stated that the internal audit system could be considered a valuable instrument for an organization's improvement, especially for the public sector institutions.

Keywords: Internal Audit, Public Sector Organizations/Institutions, Improvement Tool, Poland

1. INTRODUCTION

The issue of internal auditing has become of great interest for different kinds of institutions, among which there are profit and nonprofit enterprises, financial institutions as well as public sector entities [16, 22]. The audit function has always been viewed as a fundamental component of government financial management, and gradually more as a tool for improving the performance of the public sector organizations [4, 5, 8].

This paper has two purposes. The first one is to show the current situation of the internal audit function as used in the public sector organizations in Poland, and the second, to present an original view on the internal audit system, as an effective tool for this kind of organizations' improvement. Describing the methodology, two aspects of this concept will be stressed – functional and operational.

2. PUBLIC SECTOR ORGANIZATIONS IN POLAND

The importance and the role of the public sector in contemporary economies strongly differ. It is an outcome of various conditions that have their roots in the past. These are: the type of economic system, the kind of economic policy, the range of social tasks, the involvement of the government in the provision of public goods and services via the public sector entities.

It is difficult to evaluate the changes that occurred in 1990 - 2000 in the public sector organization in Poland [11]. Many positive developments, such as a enormous reduction of the scope of the state segment in the public sector were recorded. At

the same time, however, processes leading to disintegration of the public sector and weakening control of public assets management were of concern. Because of the fact that the public sector encompasses a huge number of entities with various organizational structure, it is very difficult to introduce regulations of fundamental importance for the economy, as e.g. those relating to public procurement and, especially, public aid. Generally speaking, such a situation contributed to ineffective use of the already very limited resources.

In the 1990s, the public sector became dominated by entities and units operating outside the state budget. Public sector entities established in the last decade include both extra budgetary economy units and appropriated funds, which have already functioned earlier, and forms being completely unknown before. As a result, efforts to decrease the number of institutions and entities created outside the state budget ended in a complete failure. Suggestions for substantial cuts in their number always appear when the expenditures are too high, and the state budget revenues too low. At that moment, a liquidation of agencies and appropriated funds seemed to be a universal remedy, but it is typical that when the budget situation improves, even temporarily everybody loses interest in such proposals.

Nowadays, the scale of the public finance disequilibrium is so great that the rigor measures possible to implement in a form of cutting the administrative expenses of the public sector and introduction of effective controls over all public institutions will alone not solve the entire problem. On the other hand, sorting out the public sector should be the first phase of its reorganization, paving the way for implementation of more crucial systemic changes. An attempt to limit the number of special funds, appropriated funds and government agencies was also embarked on in the Law on Public Finance [10].

However, the law's provision on statutory procedure of creating special funds immediately found a response in a mass enactment of acts establishing new special funds. Also the Bill through which the Council of Ministers was obliged to prepare, by the end of 1999, a feasibility study of state appropriated funds and government agencies, did not meet the expectations. Such a document (dated 31 December 1999) only contained detailed characteristics of particular entities and units, and rather unclear proposals for changes. The most important of the latter and, at the same time, the most noticeable ones concerned extension of the scope of control over confiscation of funds. Even if the functioning of funds and agencies is subjected to more rigorous governance and control, it is certain that new organizational forms with much weaker functions of control over public assets management will come into being. The

inventiveness of legislators in this field seems to have no confines [11].

Public finance is of special importance. According to the Law on Public Finances, public finance is understood as processes linked with the accumulation and allocation of public funds, particularly: the collection and accumulation of revenue, spending public funds, deficit financing, committing funds as well as the management of public funds and public debt [10].

In the sector of public finance the following organizational-legal forms of entities are operating:

- 1) budgetary entities, the expenditures of which are fully covered from the state budget or the budgets of local self-government entities, and the incomes obtained by them account for the income of these budgets;
- 2) budgetary establishments as well as auxiliary units of budgetary entities, the expenses of which are covered from own revenues from conducting activity as well as from possible objective allocations from the state budget or budgets of local self-government entities;
- 3) own income account of budgetary entities (established in 2005) is separated account on which budgetary entities accumulate incomes from closely defined sources and distribute them for no other purposes than their sources;
- 4) appropriated funds are funds created on the basis of acts, the revenues of which originate from public revenues, and the expenses are designated for the realization of specific tasks. An appropriated fund which realizes specific tasks separated from the budget of:
 - a) the state is a state appropriated fund,
 - b) a local self-government entity is a "gmina", "powiat" or "voivodship" appropriated fund [21].

Therefore, in order to ensure better functioning of the public sector organizations described above, it is important to implement appropriate control systems. Internal auditing standards applied in public sector entities were based on the Framework for the Standards for the Professional Practice of Internal Auditing [23]. As it was mentioned, the internal audit standards related to the public sector entities in Poland were included in the announcement of the Minister of Finance dated to 30 January 2003 [20].

3. THEORETICAL FOUNDATIONS OF INTERNAL AUDIT

While internal audit and external audit face similar topics [6], generally most attention has been paid to the latter. Nevertheless, recently, there has been increased interest and more emphasis is now placed on the internal audit function [5, 7, 13].

It is usual for any activity, as well as for a control activity such as internal auditing, to result as a consequence of emerging needs. The business organizations of the first half of the last century, when internal auditing was just initiated, were very different from the new millennium organizations [12].

As late as the beginning of the twenty-first century, the evolutionary practice of internal auditing resulted in developing internal audit best practices and adding value to the organization and its stakeholders by understanding the link between internal audit and organizational goals. Internal audit services were focused on detection not prevention before the enactment of Sarbanes-Oxley Act of 2002 [19]. Internal auditors were

moving from a confrontational approach to partnerships with management and moving from controls approach to a risk-based approach. They also focused on consulting services [15].

The vision report resulted in changes to the definition of internal auditing, the code of ethics, and The IIA International Standards for the Professional Practice of Internal Auditing. As seen below, the new definition of internal auditing expands the scope of internal auditing into corporate governance and risk management [24]:

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process."

The definition of internal auditing suggested by The IIA's remains to be most proactive and comprehensive. It acknowledges the changing role of internal auditing in organizations, the need for a comprehensive and adaptable framework, and the ever increasing value that the internal auditing function contributes to modern organizations of differing sizes and types.

Chapman and Anderson argue that the inclusion of assurance and consulting services in the new definition of internal auditing results in internal auditing becoming a proactive, consumer focused activity concerned with the important issues of control, risk management, and governance [3]. The definition specifically states that the internal audit function is designed to add value and improve an organization's operations [23].

The IIA standards indicate examples of assurance engagements as financial, performance, compliance, system security, and diligence audits. Examples of consulting activities include conducting internal control training, providing advice to management about the control concerns in new systems, drafting policies, and participating in quality teams. In addition, assurance services include financial auditing, performance auditing, and quick response auditing and consulting services includes assessment services, facilitation services, and remediation services [1].

These are all value-added activities and contribute to organizational success and strategic achievement. This was reflected in the revised professional practices framework which recognized that the internal audit function needed to support and promote a broad range of value-adding activities [14]. According to Krogstad et al., this also allowed for the recognition of the practice of internal auditing as evolutionary in the competitive marketplace [9].

Summing up the main findings of the internal audit function's evolution, it is important to present some, in our opinion, important concluding remarks. First of all, the nature of the internal audit has changed. Its financial bookkeeping orientation was changed by business management orientation. At the same time, the control function has altered into consulting function. Secondly, the place and role of the internal audit function in an enterprise has also changed. It underwent evolution from the typical control instrument which controls "ex post", to the contemporary, fully modern instrument supporting the process of organization management.

Furthermore, the scope of internal audit increased. Control of the organization's processes was exchanged with analysis and

improvement of the key, strategic areas concerning the organization's creation and functioning. The methodological and instrumental view on the internal audit transformed from a randomly selected analysis, which was based on intuition and differentiated level of objectivism, to the fully professional, planned, independent, objective and investigation processes.

There has been an increase in the level of qualifications of the persons in charge of delivering the internal audit function as well. In the first stage of internal audit evolution, the requirements towards auditors were limited to their factual skills. Today, apart from the wide range of knowledge, it is very important to have methodological skills and experience, as well as specific ethic values such as integrity, objectivity, confidentiality, professionalism and competency, mentioned in the Code of Ethics issued by The Institute of Internal Auditors [18, p. 15].

4. IDENTIFYING THE PROBLEMS AND INTERNAL AUDIT TOOLS IN THE PUBLIC SECTOR ENTITIES

One of the most important aspects in the process of internal auditing is to identify problems which have to be solved by implementing the appropriate internal audit tools. Based on the information from the Ministry of Finance of Poland, below are presented the topics of the tasks of internal audit that were delivered in public sector entities in 2005 [2]:

- Assessment of the budgetary revenues planning and realization;
- Assessment of the budgetary expenditures planning and realization;
- Assessment of the financial accountancy and reporting system;
- Assessment of the operational activities;
- Assessment of the Structural Funds of the European Union project realization;
- Assessment of the internal control system;
- Assessment of the earmarked funds management;
- Assessment of the cooperation with international organizations;
- Assessment of the public tenders system;
- Assessment of the supervision of materials management;
- Assessment of the administrative decisions process;
- Assessment of the organizational-administrative actions;
- Assessment of the investments planning and realization;
- Assessment of the financial accountancy documents circulation;
- Assessment of the receivables collection;
- Assessment of the Union Initiative programmes implementation;
- Assessment of the IT systems protection;
- Assessment of the correctness of financial settlement of the EU funds.

In order to choose an appropriate research method of internal audit, an auditor has to keep in mind the following elements:

- Aim of internal audit;
- Characteristics of the audited subject;
- The audit's area and task;
- Level of the internal and external risk;
- Own knowledge on the audit subject;
- Own skills and predispositions towards using the appropriate methods.

There are no precise instructions on which method to choose and when to apply it. There are following techniques of internal audit mentioned in Polish legal documents [17, 20]:

1. Official documents review
2. Obtaining information and explanations from the employees of the audited unit
3. Obtaining additional information from other employees of the audited organization
4. Observation of the tasks execution in the audited unit
5. Inspection in order to verify the present state of resources of the audited unit
6. Reconstruction of the events or calculations
7. Checking information by comparing with data from other sources
8. Comparison of the specific data collections
9. Graphical analysis of the processes
10. Sampling
11. Testing

The analysis of the above audit tasks dominating in the Polish public sector entities, enables us to make several conclusions. First of all, it is easy to notice that the main group of the tasks conducted by the public sector organizations is related to budget realization. The public sector entities are obliged to carry out their tasks in accordance with the existing law. Secondly, another group of the tasks refers to the absorption of the EU funds. The formal procedures, which are very restrictive, are regulated by the law established by the EU organs. Finally, the largest set of tasks, is related to the general functions of the public sector entities, such as public duties realization, and is delivered by these entities in accordance with existing regulations and appropriate laws.

The above mentioned sets of tasks vary, however they also have a common trait. All these tasks have a typical control function. Based on the early defined standards of legal regulations, they are aimed at identifying discrepancies between them and revealing the purposes of deviations and providing the ways for improvement.

Such a character of the auditing tasks is confirmed during their realization by the use of methods and techniques. These tools aim at information collecting and registration that is important from the point of view of the particular auditing task. The tools used for a real situation assessment of the analyzed problem or which would be helpful in defining the improvement directions are almost not applied during the auditing process of the public sector organizations in Poland.

5. INTERNAL AUDIT SYSTEM AS A CONCEPT FOR PUBLIC SECTOR ORGANIZATIONS ENHANCEMENT

The previously noted state of different internal audit tasks delivered in the public sector organizations in Poland, in our opinion, results from the significant theoretical and methodological shortages in this concept of management.

The concept of the internal audit system, presented with some simplifications in this part of the paper, seems to be an effective improvement tool for the public sector organizations.

Our assumptions behind the idea of the internal auditing system are based both on the practical problems identified in the use of internal audit in the public sector organizations in Poland, and the contemporary management concepts. In modern streams of management, the methodological trends (the system and

situation concepts) or marketing orientation (internal client), seems to be of major importance, but above all is the scientific approach leading to the perception of the internal auditing as a concept for an institution's enhancement. Considering the above assumptions, the general theoretical and methodological scientific achievements of internal auditing, valid law and legal regulations, the methodological presumptions that would enable efficient internal audit in institutions, as well as in the public sector entities, were also taken into account.

Taking into account the above considerations, the internal audit system will be defined in terms of the management concept related to the institution's improvement in the phase of its creation and functioning. Moreover, it serves the control and consultancy function through delivering of systematic, independent, objective and methodological activities, in order to support organization's managers in the process of institution's management.

Describing the internal auditing system, the following main aspects of it are worth mentioning:

- 1) Functional, in order to describe the place of the system in the concept of institution's management and to specify functions (tasks), which have to be performed by the system,
- 2) Operational, in order to define the processes (procedures) of auditing, in terms of the sequential actions to perform the functions,
- 3) Instrumental, in order to specify the collection of methods and tools, which are in use during the audit procedures aimed at completing the functions of the system,
- 4) Structural, in order to identify the organizational solutions (organizational forms) that are necessary for delivering the internal audit functions.

The above definition of the internal auditing system is a part of the modern internal auditing concept for institution's improvement, which is considered to be one among a few others. An institution is defined as an organization founded and united for a specific purpose that has existed for a long time, consisting of a team of people that have a common goal, which is permanently being repeated. Thus, an institution is an organization in which two conditions have to be met. The first one is a teamwork of people combined with other resources, and the second, is the permanent character of this activity. The entities of the public sector mentioned in the third section of the paper are also institutions, since they consist of employees and resources, and have a common, planned and prepared in advance, goal. This team is continuously renewing and repeating its actions in order to reach a defined goal. The institution defined in the above manner is seen as an object of improvement of its management and performing system in order to increase the efficiency of functioning.

In the case of the internal auditing system, an institution's improvement will be understood as the process of a planned transformation of the present solutions in the area of its construction and functioning, in a manner making better adjustment to the present and expected conditions. An institution's improving with the help of the internal auditing system should be based on the results of the diagnostic exploration and design works.

The first aspect is the most important among all mentioned above. The functional aspect unites all other ones, stands out and reveals the essence of this concept of management. All functions realized by the internal auditing system can be grouped into two general ones. First of them is the control

function, which is also called the assurance function. It is delivered in all organizational units of an institution. The control function of the internal auditing system consists of the following detailed functions:

- 1) Informative, being delivered by:
 - Supplying information necessary for taking proper decisions related to operational management, as well as for verifying and correcting the decisions already made,
 - Analyzing the level of compliance with established norms (standards, plans) of the organizational units of an institution and informing about the identified oversights, deviations from rules, negligence and fraud,
- 2) Expert, in order to prepare a report on the realization of the internal audit's control function,
- 3) Preventive, actions that are aimed at protecting from the irregularities in functioning of an institution's organizational units,
- 4) Instructive, consisting of actions such as commenting and discussing the results of the control, employees' training, in order to increase their understanding and awareness of the duties being performed.

The second dominating function of the internal auditing system is the consultancy function for other organizational units of the institution. The consultancy function of the internal auditing system consists of the next detailed functions:

- 1) Searching and designing, composed of:
 - Identifying the level of effectiveness of an institution's organizational units and specifying the development directions and how to increase effectiveness,
 - Designing new solutions to raise the effectiveness of the institution's organizational units,
 - Cooperating with directors of the audited organizational units during designing and implementing new solutions,
- 2) Expert, for preparing a report on the realization of the internal audit's consultancy function,
- 3) Coordinating, in order to agree on the changes implemented by directors of the audited organizational units,
- 4) Consultancy, refers to delivery of methodological and essential advice on the tasks performed in an institution,
- 5) Informative, to distribute information about the newest solutions in different areas of an institution's activity, in both operational and strategic tasks,
- 6) Promotional, to disseminate the principles of efficient performing among the employees.

The mentioned above functions of the internal auditing system are performed by sequences of actions via appropriate procedures. The realization procedures of internal audit refer to the operational aspect of the concept presented in this paper. Taking into account the complexity of the described problem, the performing of the specific functions can be seen as a decisive process. The algorithm is presented in Figure 1.

There are five decisive blocks in the algorithm depicted in Figure 1 that enable to execute the improvement process of the whole institution's or only of its specific parts. The process of internal auditing consists of the seven phases that are included in two general modules. The first of them is related the control function, and the second one to the consultancy function.

The functional aspect of the internal auditing system specifies in detail the sequence of actions related to the control and consultancy functions of internal auditing. The procedure of the internal audit's control function as a general model of monitoring and assessment of an audit object is performed in the following stages:

- 1) Defining the audit object, aim and scope,
 - 2) Preliminary identification of an object and selection of the examination method,
 - 3) Assessment criteria selection and description,
 - 4) Developing principles for measuring and evaluation, and assessment standards,
 - 5) Identification of the factual situation and diagnostic conclusions,
 - 6) Verification and interpretation of the diagnostic conclusions,
 - 7) Synthesis of the examination results and report preparing.
- The procedure of the internal audit's consultancy function covers the following sequences of the actions:
- 1) Defining the examination aim and object,
 - 2) Selecting the method for problem solving,
 - 3) Selecting the methodological concept of change implementation,
 - 4) Preparing the improvement design,
 - 5) Obtaining the acceptance of the improvement design and for its implementation,
 - 6) Planning the project implementation,
 - 7) Establishing the rules and ways for improvement actions monitoring,
 - 8) Defining the employees development methods,
 - 9) Implementation of the solution,
 - 10) Control of the improvement process.

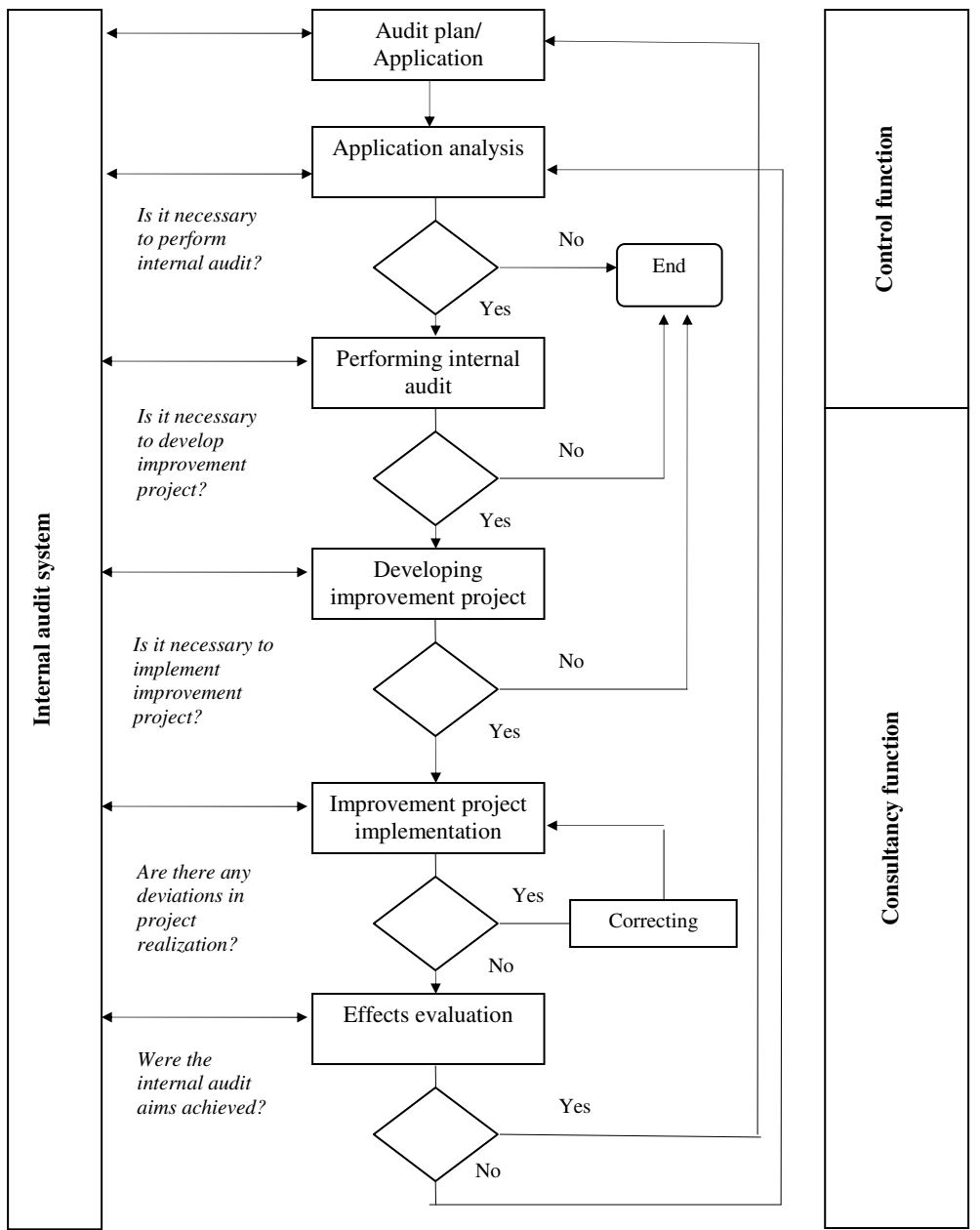
Additionally, the essence of the internal audit system constitutes of two other aspects – the instrumental and structural. These aspects, together with those mentioned earlier, describe the unique dimension of the internal audit system and let consider it to be an interesting concept for improving public sector organizations.

6. CONCLUDING REMARKS

The purpose of this paper was to present briefly the internal audit system which, in our opinion, could be considered an effective instrument for an organization's improvement, as well as for the public sector organizations. The first attempts of using it, support our assumptions. Further research in this area will concentrate on two other aspects of the internal auditing system – instrumental and structural. The main goal of the future investigation will be to specify the procedures of the particular functions, but most important, to identify the nature and specifics of a sector in which the procedures are performed.

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Functions of the internal audit system

Figure 1. Decision algorithm of the internal audit system