

INTERNAL AUDITING AS A TOOL FOR REDUCING RISK IN A TURBULENT ENVIRONMENT

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Abstract:

Modern organizations are functioning in a turbulent environment, which makes that part of their operations a risk. The organizations should take actions designed to reduce the risk. One way to do that is to carry out an audit. The aim of this article is to introduce the concept of internal auditing in terms of Polish law applicable to public organizations. The research methods used in this article include: literature review, analysis of Polish legislation in terms of internal auditing activity.

Keywords: internal audit, risk management, Polish law, public organization

1. INTRODUCTION

Risk is inherent to functioning of modern organizations. For a modern organization is a system intertwined into a network of relationships and dependencies with other entities. To survive, it must be able to predict and adapt to changes in the environment. This makes the management face certain challenges. Searching for enterprise management solutions gave rise to emergence of new concepts of management, such as e.g. trust management and risk management. The use of specific management methods and strategies is evaluated and this evaluation may take the form of external or internal audit. Internal auditing may be an effective tool for assessing risk management and building trust in an organization.

2. INTERNAL AUDIT – CONCEPT AND STANDARDS

The literature review has shown that an audit is defined in numerous normative documents, as well as international guidelines and standards. In addition, auditing may be internal or external. The basic differences between the two refer to, among others: mandate, reporting lines, areas of focus, independence, driving the results (An auditor is an auditor ... right?, 2012).

In the beginning, the internal auditing concept was associated with financial aspects of an organization. With time, it also started to refer to other management-related areas (Ciechan-Kujawa, 2014, p. 71-72; Lisiński, 2011, p. 36-39).

In the process of developing the internal audit definition, a particularly important role was played by The Institute of Internal Auditors. According to The Institute of Internal Auditors, 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 processes (Definition of Internal Auditing, 2012). Internal auditing is conducted by persons within or outside the organization.

The Institute of Internal Auditors developed International Standards for the Professional Practice of Internal Auditing pertaining to Attribute and Performance Standards. These standards are characterized in Table 1.

Table 1: Characteristics of International Standards for the Professional Practice of Internal Auditing

Standard	Description
Attribute Standard	
Purpose, Authority, and Responsibility	The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards.
Independence and Objectivity	The internal audit activity must be independent, and internal auditors must be objective in performing their work.
Proficiency and Due Professional Care	Engagements must be performed with proficiency and due professional care.
Quality Assurance and Improvement Program	The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.
Performance Standards	
Managing the Internal Audit Activity	The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization.
Nature of Work	The internal audit activity must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.
Engagement Planning	Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations.
Performing the Engagement	Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement's objectives.
Communicating Results	Internal auditors must communicate the results of engagements.
Monitoring Progress	The chief audit executive must establish and maintain a system to

	monitor the disposition of results communicated to management.
Communicating the Acceptance of Risks	When the management has accepted an excessively high level of risk, the chief audit executive must discuss the matter with the management – in case of no response, the chief audit executive must communicate the matter to the board.

Source: A study based on: International Standards for the Professional Practice of Internal Auditing (Standards), The Institute of Internal Auditors, 2012, p. 3-18.

It should be added that The Institute of Internal Auditors also developed The Code of Ethics promoting ethical principles to be followed during practising as an internal auditor. Internal auditor's activity should be characterized by: integrity, objectivity, confidentiality, competency (Code of Ethics, 2009, p.1).

3. THE ROLES OF INTERNAL AUDITING IN RISK MANAGEMENT

Growing expectations from stakeholders are forcing internal audit functions to take a fresh look at their role in the organization and to shift their focus to align with organizational objectives. One of the areas that has gained prominence is internal auditing role and contribution in promoting an efficient and effective risk management program (Risk management practices and the role of internal audit, 2015, p. 39).

Risk should be construed as the possibility of an event occurring that will have an impact on the achievement of objectives; risk is measured in terms of its impact and likelihood. Risk management on the other hand, is defined as the process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives (International Standards for the Professional Practice of Internal Auditing (Standards), 2012, p. 22).

One of the International Standards for the Professional Practice of Internal Auditing addresses the issue of risk management. It says that: "The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes". Risk management processes are effective, if:

- organizational objectives align with the organization's mission,
- basic risks are identified and assessed,
- appropriate risk responses are planned,
- relevant risk information is captured and communicated to staff, management and the board of an organization (International Standards for the Professional Practice of Internal Auditing (Standards), 2012, p. 11).

Studies published by The Institute of Internal Auditors have stressed that internal auditing has appropriate impact on risk management processes when providing objective assurance that the major business risks are being managed appropriately and providing assurance that the risk management and internal control framework is operating effectively. Also, roles of internal audit activity should, and equally important, should not undertake in risk management, were indicated (The role of internal auditing in enterprise-wide risk management, 2009, p. 3). Table 2 presents the roles that should be undertaken by internal audit in risk management.

Table 2: The roles of internal audit in enterprise risk management (ERM)¹

Core Internal Auditing Roles in ERM	Legitimate internal auditing roles with safeguards
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¹ Enterprise-wide risk management (ERM) is a structured, consistent and continuous process across the whole organization for identifying, assessing, deciding on responses to and reporting on opportunities and threats that affect the achievement of its objectives.

<ul style="list-style-type: none"> • Giving assurance on risk management processes • Giving assurance that risks are correctly evaluated • Evaluating risk management processes • Evaluating the reporting of risks • Reviewing the management of key risks <p>Core Internal Auditing Roles in ERM</p> <ul style="list-style-type: none"> • Giving assurance on risk management processes 	<ul style="list-style-type: none"> • Facilitating identification and evaluation of risks • Coaching management in responding to risks • Coordinating ERM activities • Consolidating the reporting on risks • Maintaining and developing the ERM framework • Championing establishment of ERM • Developing risk management strategy for board approval
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Source: The role of internal auditing in enterprise-wide risk management, 2009, p. 4.

Internal audit is a catalyst for improving an organization's governance, risk management and management controls by providing insight and recommendations based on analyses and assessments of data and business processes (The role of internal audit in risk management, 10.03.2016).

4. INTERNAL AUDITING AS A RISK-REDUCING TOOL IN POLISH PUBLIC ORGANIZATIONS IN THE LIGHT OF LEGAL PROVISIONS

In Poland, the concept of internal auditing may be related to public organizations being public finance sector entities. This part of the article was based on the analysis of Polish legislation in terms of internal auditing activity.

The basic legal instruments governing the internal auditing issues in the case of these entities include:

- Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych (Public Finance Act of 27 August 2009²),
- Rozporządzenie Ministra Finansów z dnia 4 września 2015 r. w sprawie audytu wewnętrznego oraz informacji o pracy i wynikach tego audytu (Regulation of the Minister of Finance of 4 September 2015 on internal auditing, auditing activities and audit results),
- Ustawa z dnia 29 września 1994 r. o rachunkowości (Accounting Act of 29 September 1994).

The public finance sector, in line with provisions of the Public Finance Act, is comprised of, among others: public authorities, local self-government units, state entities, state special purpose funds, public autonomous healthcare units, public education institutions, state and local government cultural institutions.

Pursuant to Article 272 of the Act, internal auditing is an independent and objective activity with the aim to support the minister in charge of a department or head of a unit in fulfillment of goals and tasks through systematic evaluation of management control, and to provide advisory services. The evaluation concerns the relevance, performance and efficacy of management control.

Internal auditing should be performed by an internal auditor employed by a unit or service provider not employed in the unit. Pursuant to the Act, the internal auditing obligation is imposed on, including but not limited to, ministries, customs chambers, provincial offices, revenue offices, public education institutions, public autonomous healthcare units, state special purpose funds.

It should be noted that internal auditing standards for public finance sector entities set out by the Minister of Finance in the communication comply with International Standards for the Professional Practice of Internal Auditing (Komunikat nr 2 Ministra Finansów z dnia 17 czerwca 2013 r. w sprawie standardów audytu wewnętrznego dla jednostek sektora finansów publicznych - Communication no. 2 of the Minister of Finance of 17 June 2013 regarding internal auditing standards for public finance sector entities).

The Act sets out the requirements to be met by internal auditors. Pursuant to Article 286 of the Act, in order to work as an internal auditor, an individual:

² Hereinafter referred to as the Act.

- must have the nationality of an EU Member State or any country whose residents, pursuant to international agreements or provisions of Community law, has the right to take up employment on the territory of the Republic of Poland,
- must have full legal capacity and enjoys full public rights,
- was not penalized for intentional crime or intentional tax offence,
- has higher education,
- has specific qualifications to conduct internal audits related to, e.g. certificates issued by international auditing organizations³ or qualifications of a certified auditor, or completed two-year internal auditing training and graduated from postgraduate internal auditing program.

Internal audit is carried out in accordance with the Annual Internal Audit Plan drawn up on the basis of a risk analysis. Risk analysis is performed by the head of internal auditing function and considers: unit goals and tasks, risks affecting realization of unit goals and tasks and results of previous audits and controls (Regulation of the Minister of Finance on 4 September 2015 on internal auditing, audit activities and audit results).

While proceeding with audit activities, an auditor acts in accordance with the following steps:

- preparation of an internal audit plan,
- conduct of preliminary review, involving:
 1. learning about goals and business operations of the unit,
 2. risk identification and assessment, upon consideration of the existing control mechanisms;
 3. agreeing, with the audited entity, on control mechanism evaluation criteria in the area of audited unit operations,
- preparation of the audit schedule,
- performance of the audit,
- drawing up of an audit report,
- control activities (Regulation of the Minister of Finance on 4 September 2015 on internal auditing, audit activities and audit results).

An internal auditor may also conduct advisory activities to support the head of the function in realization of goals and tasks and present suggestions intended to improve unit functioning.

Head of the internal auditing function is obliged to draw up the annual audit implementation report for the preceding year by the end of January each year.

It should be added that the head of the internal auditing function reports directly to the board of the organization, which ensures independence of his assessment.

Functioning of a unit is assessed during internal audit using the following criteria:

- legality, that is compliance with the law,
- economy, that is the ability to manage the owned resources,
- purpose, that is matching the resources to assumed goals,
- accuracy, that is performance of tasks with utmost care,
- financial transparency,
- disclosure, that is data availability (Kiziukiewicz, 2013, p. 20-22).

Thus conducted evaluation makes internal auditing treated as a tool supporting organization management, also in the area of risk.

5. CONCLUSIONS

In the light of Polish provisions, internal auditing is an obligatory control conducted in public finance sector units. In the beginning, the internal auditing concept was associated with financial aspects of public organization. With time, it also started to refer to other management-related elements.

³ Such organizations include: Certified Internal Auditor (CIA), Certified Government Auditing Professional (CGAP), Certified Information Systems Auditor (CISA), Association of Chartered Certified Accountants (ACCA), Certified Fraud Examiner (CFE), Certification in Control Self Assessment (CCSA), Certified Financial Services Auditor (CFSA) or Chartered Financial Analyst (CFA).

Correctly conducted internal audit helps the head of the unit to make sure that:

- goals set before the unit are properly implemented,
- the unit operates in accordance with rules and procedures under legal provisions,
- the adopted management control system is relevant and effective, enabling to evaluate unit operations (Kiziukiewicz, 2013, p.19).

This assures the head of the unit that the ongoing processes are correct, i.e. that the unit displays a satisfactory level of trust at specific costs, benefits and risks.

The study indicates that internal audit may be a successful risk management-supporting tool.

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