

ANALYSIS OF INTERNAL AUDIT FUNCTIONING IN POLAND – EMPIRICAL RESEARCH FINDINGS

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Abstract. The purpose of the article was to present the research conducted in companies, concerning the functioning of internal audit in Poland. During the research, the author identified a number of barriers reducing the efficiency of the cells of internal audit and audit as an instrument for company improvement. One also indicated areas which, from the point of view of internal audit efficiency as well as of the company functioning, should be improved.

Keywords: audit, system of internal audit, improvement, company, instrument.

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1. Introduction

Proper business management, as shown by the most recent economic events, is presently becoming one of the most significant factors not only of its competitive advantage, but even of its existence. Undoubtedly, an important role may be played by internal audit. However, only its existence does not guarantee the company's success. Therefore, the author decided to carry out an empirical research, aimed at identification of the actual condition for internal audit application in a company, the principles of its functioning, indication of barriers making it difficult to use it, specification of the scope of implemented internal audit tasks, and the possibility to use it as a tool for the company improvement.

The purpose of the article is to present and analyze the results of empirical research concerning the functioning of internal audit in Polish companies. Additionally, we will try indicating the areas of audit functioning which require improvement.

2. Internal audit as evaluated by empirical research

The purpose of the research, as mentioned above, was to identify the functioning of internal audit in companies¹. Due to the differences resulting from the principles of functioning and conducting internal audit in private and public companies, one decided to conduct the research in these two sectors separately².

The entire research was conducted in the period from October 2008 to May 2009.

The survey covered 137 enterprises in total (57 institutions operating in the public sector, and 80 from the private sector). The survey was sent to people who know the principles of audit functioning in the company. These were mainly managers of internal audit cells, auditors working in cells, directors, company managers, presidents or members of the management board, supervisory board³.

In the research, one applied research methods, such as: survey questionnaire, personal interviewing (direct), telephone interviewing (CATI, PAPI), document analysis technique, analysis of reference books, with particular focus on comparative analysis, diagnosis, synthesis and deduction.

Statistical methods, including non-parametric measures of stochastic dependence – measures of quality features association (i.e. V Cramér coefficient, φ Yule coefficient), Pearson's independence test χ^2 . In the case of quantitative variables – measures of location, variability and asymmetry (Bielińska-Dusza 2009)⁴.

¹ Companies in Poland, from the point of view of the ownership form, are divided into two sectors: public and private. Public sector includes: the State Treasury companies, companies of state legal persons, companies of local government units (municipal). On the other hand, the private sector includes: companies of national natural persons, companies of other national private entities, companies of foreign entities.

² In the public sector the obligation of internal audit implementation is regulated by acts and regulations such as, among others: the Act of 27 July 2001 on the amendment of the Act on public finance, of the Act on organization and operating mode of the Council of Ministers and the scope of operation of ministers, of the Act on activities of government administration and of the Act on civil service, Journal of Laws 102(1116): 7483–7493; The Act of 30 June 2005 on public finance, Journal of Laws 249(2104): 27–34, with later amendments; Announcement No. 1 of the Minister of Finance of 30 January 2003 on announcing “Standards of financial control in public finance sector entities”, Official Journal of the Minister of Finance 3(13): 1–8; Announcement No. 11 of the Minister of Finance of 26 June 2006 on standards of internal audit in public finance sector entities, Official Journal of the Minister of Finance 7(56): 1–13. Announcement 16/2006 of the Minister of Finance of 18 July 2006 on announcing “The code of ethics of the internal auditor in public finance sector entities” and “The card of internal audit in public finance sector entities”, Official Journal of the Minister of Finance 9(70): 1–6.

Regulation of the Minister of Finance of 10 April 2008 on the detailed method and mode of internal audit performance, Journal of Laws 66(406): 3698–3705; Regulation of the Minister of Finance of 24 June 2006 on the detailed method and procedure for internal audit performance, Journal of Laws 112(765): 5747–5754; Regulation of the Minister of Finance of 24 June 2006 on the mode of preparation and the template of the report on internal audit plan execution, Journal of Laws 112(764): 5742–5746.

Announcement 6/KF/2004 of the Minister of Finance of 28 April 2004 on announcing “The code of ethics of the internal auditor in public finance sector entities” and “The card of internal audit in public finance sector entities”, Official Journal of the Minister of Finance 5(28): 1–12. Regulation of the Minister of Finance of 4 April 2008 on the mode of preparation and the template of the report on audit plan execution for the previous year, Journal of Laws 61(378): 3359–3362.

³All questions set forth in the questionnaire were brought down to several key problematic areas. The scope of these questions included issues related to the functional, subject, instrumental and structural aspects of internal audit.

⁴If you are interested in the details related to the whole process of research, see: Bielińska-Dusza 2009: 214 and further.

The obtained test results clearly indicate that the functioning of internal audit in the examined companies requires introduction of changes, which will make internal audit an effective instrument of the company improvement, used to a various extent and in various directions, and will contribute to further strengthening of internal audit's role in a company (Lisiński 2011; Aniunas *et al.* 2009)⁵.

The tradition of audit in the Polish reality is relatively young. Despite clear irregularities in its functioning, managers see *the importance of this concept's implementation for a company, as well as its suitability*. Unfortunately, in the opinion of managers, this suitability is only average⁶.

The respondents also believe that internal audit affects to a large extent the company's improvement, effectiveness of implemented solutions and economy for the company. However, with the great need for internal audit implementation, its effectiveness was assessed only as average. It gives grounds for stating that one should consider introduction of changes with regard to the principles of internal audit functioning.

On the other hand, the impact of the effectiveness of solutions implemented during implementation of the audit task on elimination of the identified irregularities in the examined companies is moderate. What is interesting, the largest number of the examined people stated that the large extent of irregularities elimination contributes only moderately to the growth of audit effectiveness. On the other hand, it is important that both managers and auditors evaluate effectiveness at the same level.

Respondents who were asked to compare the suitability of external and internal audit clearly prefer internal audit. It allows us to make a hypothesis that *the effectiveness of internal audit increases when it has the form of internal rather than external audit*. It results, among others, from low evaluation of the effectiveness of recommendations implemented in the case of external audit.

However, the need for further performance of internal and external audit and evaluation of its suitability to the same extent is evaluated both by managers and auditors. An important thing is also the fact that the greater the need for further performance of external audit, the greater its suitability. What is interesting, the need for audit implementation is greater among company management than employees.

It seems that the lack of very high or full understanding of the need and suitability of audit results, among other problematic issues, in the lack of full commitment of both the managers and employees to the implementation of recommendations. When determining the commitment of employees, more than $\frac{3}{4}$ of respondents pointed out to average and high commitment. With regard to managerial staff, such answers were given by more than a half of respondents.

⁵ More information concerning the concept of audit as an audit system used for improvement of institutions in Lisiński, M. (Ed.). 2011, PWE, Warsaw.

⁶ The scale included the following values: full, very high, high, medium, low.

In addition, the commitment of managers in the examined companies does not affect the level of commitment among employees. However, the respondents see the relation between the high level of commitment of managers and employees and the effectiveness of the implemented recommendations. Since this relationship is positive, this means that the higher the commitment of managers, the higher the commitment of employees and the effectiveness of audit. This conclusion raises a qualitative new aspect in relations between the managerial staff and the remaining groups of employees, which should be used in the process of internal audit improvement.

Another group of questions determined another problematic area. It applied to the barriers hindering efficient application of audit.

The basis seems to be the respect for principles, which determine the purpose of internal audit in the convention of its description as we have adopted, namely from the point of view of seeing it as an institution improvement instrument. Such research consideration imposes, in a way, the need to take into account, in the course of practical research, the rules falling within the essence of internal audit. From the conducted research it seems that *the degree of compliance with the principles resulting from the nature of internal audit is varied* and is primarily determined by the auditor, his or her competences, as well as situational conditions of the problem being solved and the institution itself.

In addition, audit implementation should take place according to a specific procedure. In the examined companies, the auditors apply the procedure only to an average extent. On the other hand, from the analysis of answers it seems that the irregularities apply not only to the sequence of the research procedure's phases, namely the lack of consistency of partial audit tasks being implemented in their course, but also from marginalization of the stages of this process, crucial for the final effect (this applies to the selection and definition of evaluation criteria, development of the principles for measurement and evaluation, as well as evaluation patterns). In addition, the conduct of auditors is closer to the pattern existent in institutions of the public rather than private sector.

Even the obvious need to become familiar with the results of the previous report before a new audit is not fulfilled either. Only 64% of respondents declare that, before audit, they become familiar with these findings to a full and very large extent.

Another methodological factor identified in the course of empirical research was the application of *auxiliary methods and techniques* suitable for a given activity and its given circumstances. The research showed that a set of tools applied by auditors is poor and, unfortunately, not adjusted to the whole audit process. The instruments most commonly applied by auditors in the course of audit include: an interview, a plan of audit, a notice of audit, an analysis of source materials, a direct observation, a check list, a documentation analysis, interviewing, an analysis of control protocols, a verification and a questionnaire.

Another barrier for internal audit implementation is organizational factors. They comprise, first of all, of structural solutions, which should facilitate undertaking and

performance of internal audit. From the conducted research it seems that *the set of identified structural solutions to internal audit is modest*. The dominant ones are internal audit cells, as solutions functioning within the existing organizational structure, or advisory institutions, as specialized external entities. The respondents do not even indicate other, more flexible organizational forms (e.g. project teams or sector project teams), which is confirmed by their dim orientation in this area of organizational factors ensuring implementation of internal audit tasks.

Additionally, within this set of barriers, in the course of research, we identified a *low level of cooperation between auditors and other employees of the company*. Also, in the case of cooperation between internal and external auditors and internal control, there is still much to do. In most companies, there is no employee dealing with contacts with the auditor on a current basis. Cooperation between an internal audit cell and the audited units consist mainly in exchange of information. In addition, coordination of works between an internal and external auditor was also evaluated as low, which proves poor cooperation between them and indicates reduction in internal audit effectiveness. Identification of only cooperation without investing, for instance, in IT equipment, specialized software, training of employees, developing appropriate organizational culture, may also prove poorly effective. In addition, we notice that in both sectors, there are huge shortages of auditors in internal audit cells. In the private sector, this value amounts to 3 posts, while in the public sector it is only 1.45 post. Additionally, one should pay attention to highly diverse number of the auditors employed in the examined companies. Most companies have 0.66 posts for an auditor.

During the research, one tried to identify the area concerning *qualifications of auditors*. The respondents, beyond any doubt, indicated that the scope of knowledge needed on an auditor's position is very broad and includes a number of domains, among others: organization and management, finance, law, accounting, human resources, EU funds, IT and statistic. However, we noticed that the degree of increasing knowledge by auditors is not satisfactory. 66% of respondents pointed out to a large and average degree, and more than 13% – low. Research analysis shows that increasing qualifications result in increased effectiveness of implemented solutions. This dependence seems to be obvious but, according to the respondents, it is not high.

However, when conducting further analysis of the results, one can notice that if the auditors already increase their qualifications, the main areas of improvement are the ones associated with improvement of human resource management functions, improvement of accounting-financial processes or improvement of the existing mechanisms of control.

Another area identified by a group of questions to managers and auditors applies to implementation of internal audit tasks, also in the context of fulfilling the objectives of an institution. The obtained results allow formulating a conclusion that *internal audit is an effective instrument of the institutional improvement when contributes to implementation of the institution's objectives, is an element of the planning system, and by eliminating the irregularities it improves the entity's efficiency*. Such conclusion results from the statistical analysis of answers given by respondents to specific questions.

To the question about *the degree of connection between internal audit and the function of planning* in a company, more than half of the respondents answered that it was medium and high. Only 13% of respondents answered that it was very high and full. On the other hand, when answering the question of whether audit *contributes to implementation of the company objectives*, only 1/3 of the respondents said it contributed to a full and very large extent, while 3/4 – to a medium and large extent. In addition, improvement of strategic planning was mentioned by only 2% of respondents. It is one of the least frequently audited areas in a company, despite the fact that this is the most important problem from the point of view of an organization's development. The study also confirmed that taking audit into consideration during planning affects the effectiveness of implemented solutions. Unfortunately, in the case of the examined companies, taking internal audit into consideration at the stage of planning is insufficient, and audit contributes to implementation of the company's objectives to a medium extent.

The question about the degree of elimination of irregularities identified in the course of the auditing process leads to surprising answers. Only *slightly more than 12% of respondents state that audit is a fully effective tool of elimination of the organization's dysfunctions*.

Still worse is the analysis of answers concerning the impact of internal audit on the organization improvement. Only in the opinion of nearly 6% of respondents, can this impact be identified as direct and full, which means that for as many as *than 93% of respondents internal audit is not an effective instrument of the institution improvement*.

The summary of the results of answers to questions concerning this problematic area of internal audit may be related to *the number of implemented recommendations*. It is the actual measure of internal audit effectiveness. The analysis of answers given by the respondents *indicates an unsatisfactory condition* of this criterion of internal audit evaluation. This is alarming, because the very demanding procedure of a recommendation acceptance for the purpose of its implementation (including the need for a positive decision of several decision-makers) should assure the effectiveness of this process. Meanwhile, the research shows that only 77% of recommendations are implemented in public institutions, and 88% in private institutions. The analysis of this phenomenon over the period of the last three years allows noticing that in public sector institutions, this ratio was more than 60%, and in private sector entities – approximately 90%. However, these results have different meaning when one takes into consideration the number of the suggested recommendations. The quantity of formulated recommendations is greater in public sector institutions than in the entities of the private sector.

Another barrier influencing the effectiveness of audit is a number of *difficulties concerning both audit planning process and the process of its implementation*. The most commonly mentioned difficulty in *the audit planning process* was the lack of time. On the second place the respondents indicated difficulties resulting from information disturbances. Organizational impediments are the next group of limitations. The fourth limitation was associated with too small number of auditors. On the other hand, the difficulties in *the process of audit implementation* included lack of time, resistance of

employees towards changes, as well as organizational difficulties, information disturbances and work overload among auditors.

When preparing questions and in the course of their future analysis, one took into account the assumption that implementation of the advisory function of internal audit affects its effectiveness to a greater extent than implementation of the control function, which was confirmed in the implemented research. For verification one took into account the following parameters: the degree of connection between internal audit and planning in a company, the scope of internal audit and level of employee commitment in the implementation of recommendations, the level of managers' commitment in the implementation of recommendations, implementation of the assumed objectives of the company and suitability of internal audit.

The degree of connection between internal audit and planning in a company is higher in the case of the advisory function of audit. Also, the advisory function of audit to a greater extent affects the effectiveness of internal audit.

From the point of view of the scope of audit, both the control and the advisory function to a similar extent affect the effectiveness of internal audit. However, in the event of the advisory function, these are, to a greater extent, actions including basic rather than additional activity.

Also, the degree of commitment among employees and managers, the degree of implementation of the objectives assumed by the company, as well as suitability of internal audit is higher in the event when internal audit has the advisory function rather than the control function. It was also noticed that in the case of the advisory function managers are more involved in the implementation of recommendations than employees. It seems that this is associated, i.e. with the pejorative meaning of control.

In addition, from the conducted research it also seems that in the private sector the main function of audit is nothing else but control and assessment. The advisory function was barely on the fourth place, as opposed to the public sector, where the advisory function was the most important one, though the assessment and signalling functions were selected as the next ones. At the very end the respondents indicated the inspiring and instruction-providing functions, which show that the perception of audit is not clearly related to designing new solutions.

One should also emphasize the importance of external factors conditioning the efficient functioning of internal audit. One emphasizes that every entity is only relatively separated from the environment without which it cannot exist or develop. The environment shapes the conditions of the company's functioning, but also verifies the results of its operations. Internal audit takes from the environment not only the resources which are the condition for its functioning, but also one should pay attention to the need for respect for the environment's requirements. Within the environment of internal audit one distinguishes closer and further environment. A characteristic feature of the phenomena in the environment is their variability over time and space. Therefore, internal audit should contribute to immediate identification of any emerging opportunities and hazards, as well as promptly use or eliminate them.

The spheres of further environment, by unidirectional influence on an internal audit cell, determine the conditions for its functioning. They result in e.g. faster diffusion of technical and organizational innovations, free flow of people, capital, products. They are the factors defining the tasks of internal audit system. An important component of further environment is social environment. It evaluates the functioning of audit, e.g. from the point of view of the ethics of running business operations, compliance with standards and rules of functioning established by its legislation bodies. At this point, one cannot help but notice the special role of legal environment.

On the other hand, closer environment of internal audit is formed by bilateral relations between it and its stakeholders. They imply, e.g. the thematic scope of audit tasks, selection of an entity performing external audit, relations of entities with an organizational unit of the internal audit system. However, at the same time, the system of internal audit, performing its functions, affects the improvement in the institution's competitiveness, builds its image in the environment, co-creates the market position.

By shortly discussing the findings of empirical research into internal audit in terms of its assessment as a concept of management, we may notice a number of interesting and inspiring conclusions. We described the most important ones when discussing the results of surveys. We will notice here that they only confirm the not perfect condition of internal audit, identified in an overall and sometimes intuitive manner, both in the institutions of public and private sector. A number of observed inefficiencies affects its present image. On the other hand, however, the information obtained in the course of empirical research clearly indicates the need for firm changes in internal audit. The most important changes are presented in further parts of the article.

3. Requirements for effective use of internal audit system

As noticed before, as a result dynamic changes in the environment, companies try to create such a system of management that would provide them with sustainable competitive advantage.

An important function of the internal audit system is the control function. Over the years, managers were trying to find such form of control that would provide them with almost total protection against various kinds of pathology and irregularities. However, experiences in this respect clearly indicate that there is no ideal system that could protect an organization against dysfunctions. It also seems that there is no solution that would, by itself, ensure efficient functioning of the company. On the other hand, expectation of such a miraculous power would point out more to misunderstanding of the very essence of control rather than to the inefficiency of its creators.

When characterizing the origin of internal audit, one noticed that, over the years, audit was constantly transforming (Bielińska-Dusza 2009; Kuc 2008; Sawyer *et al.* 2003; Soltani 2007; Winiarska 2008; Moeller 2005; Savčuk 2007; Kiziukiewicz 2007; Grundey 2008; Jurkstiene *et al.* 2008; Standards... 2001).

Its objectives, functions, tasks were evolving and, first of all, the view on its essence was changing. One can clearly see this on the example of characteristics of the conceptual scope of internal audit. Since the moment of establishing the definition of internal audit suggested by IIA in 1947, in which one tried to draw attention to the fact that it should include not only financial-accounting but also operational activities, many concepts of audit's functioning have appeared so far.

The conducted empirical research, along with assessment of the present condition of internal audit in Poland, create the basis for ordering and presentation of the most important indications conditioning effective use of this concept of management⁷.

The first directive should apply to reference to the essence of internal audit and understanding it from the point of view of the present requirements and expectations. This will enable determination of internal audit tasks implemented under two functions: control and advisory ones, including all areas of the company, however, taking account of the risk and importance for the company.

Another guideline should be *looking at internal audit through the concepts of system-based and situation-based approach*. Internal audit should use the existing achievements in this field, so as to effectively face the challenges of both theory and practice. Such perspective gives a completely different dimension of knowledge, enabling comprehensive, static-dynamic perception of the organization management process.

Thanks to that, it is possible to understand the functioning of the entire system, and not only to get to know it through presentation of separated parts without comprehensive vision of their internal and external interactions. It seems that change in the way of perceiving internal audit and using it as an element of the system may be a difficult task. It requires us to notice that it has the possibility of not only affecting the remaining elements of this system, but is also continuously interacting with them. The result of this would be, as it seems, the possibility of understanding the actual dynamics of the company, taking into consideration both the external environment, internal environment, the organization's environment and multi-directional interactions among these variables. It would enable a holistic analysis of the strategic operation of the company and its development, without the concern for losing the entire vision. Therefore, internal audit should be taken into account at the stage of not only verification of the degree of the strategy execution, but also of its preparation and implementation.

It is important both for theoreticians and practitioners dealing with internal audit in the Polish reality to take account of the existence of specific situational conditions. This is important, i.e. because internal audit did not develop under our conditions. For this reason, one should not indiscriminately copy external patterns, but skilfully adjust them to the situation in the country.

Both the system-based and situation-based approach shall determine also adjustment of relevant tasks, activities, tools, structural solutions and the possessed resources to

⁷ More information in Bielińska-Dusza (2009).

carry out the whole process of internal audit. This means that, when performing audit, one has to realize the complexity of every situation, as well as actively aim at choosing such a solution that, in each case, will function in the best possible way.

Since internal audit is a concept characterized by modularity and iterativity, it is important for the whole *process of auditing to proceed according to a specific methodology*. It is important for it to be possible to apply under particular conditions, adequate to the needs and to lead to achieving the goal. Another extremely important element of the internal audit methodology is *the selection of proper methods and techniques*. This is a difficult and highly responsible task. The purpose of auditors will be to select them in such a way, so that in a particular case, they contributed to achieving the assumed objectives in the best possible way. However, one should emphasize that both the purpose, subject and scope of a particular audit task will show specific tendencies concerning the selection of methods and techniques.

The effectiveness of applying the internal audit system is also influenced by *the use of proper structural solutions*. Traditional forms suggest creating an internal audit cell subordinate directly to the company director or establishing an audit committee. However, taking into account a wide thematic range of internal audit, we offer *display and application of organizational forms consisting in using temporarily formed project teams*, using the potential, knowledge and experience of the company's employees. In the case of external audit implementation, it would be beneficial to create specialized teams associated with particular industries, dealing with specific research issues.

Another important recommendation determining the effectiveness of internal audit is support and active commitment of management in the implementation of the whole process and co-participation of all employees in implementing the improvements. One should also emphasize the importance of the role played by managers throughout the entire improvement process.

Possession and maintenance of high competences by auditors is a significant premise for effectiveness of the whole audit process implementation⁸. The level of auditors' qualifications will guarantee not only proper selection of tasks, activities, but also detailed methods and techniques in the process of the internal audit execution. This will also allow understanding the principles of the company functioning, application of knowledge in the field of management sciences, practical and theoretical knowledge about audit, as well as will contribute to ensuring the personal credibility of an auditor in a company.

4. Conclusions

Turbulence of the environment puts new challenges both for the theoreticians as well as practitioners who should be focused on creation and use of the company's potential. Adaptation of a company to the changing conditions, and consequently, its improvement, is becoming an inseparable action and condition for the organization's existence.

⁸ On the topic of competence of quality management systems auditors: Kaziliūnas (2008).

In addition, the turbulence of the environment generates different problems and hazards. In a way, a response to the demand for this protection of an organization against the existing and potential problems was the emergence of internal audit. Since the moment it was formed until now it has come through a long evolution. In Poland audit introduction was a consequence of introducing an act, which imposed the obligation to implement audit. It has been functioning for more than 10 years and, as research shows, requires improvements. We notice that examined enterprises make use of audit to introduce improvements, however this use is not satisfactory.

All of the above recommendations should be subject to a supreme rule, so that internal audit became an efficient management tool, aiming at improvement of the institution under the conditions of turbulent and unpredictable environment, so that it could meet the expectations of the managerial staff of the institution and was permanently included in the whole arsenal of instruments for management of these entities.

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VIDAUS AUDITO ANALIZĖ IR BŪKLĖ LENKIJOJE – EMPIRINIO TYRIMO REZULTATAI

E. Bielińska-Dusza

Santrauka

Straipsnio tikslas – pristatyti Lenkijos vidaus audito įmonių tyrimų rezultatus. Tyrimo metu buvo nustatytos pagrindinės vidaus audito kliūtys ir numatytos priemonės didinti vidaus audito įmonių bei vidaus audito skyrių veiklos efektyvumą. Taip pat buvo nustatytos tobulintinos įmonių valdymo sritys, atsižvelgiant į vidaus audito rezultatus ir įmonių tikslus.

Reikšminiai žodžiai: auditas, vidaus audito sistema, vidaus audito tobulinimo priemonės.

Edyta BIELIŃSKA-DUSZA, PhD, is an assistant in the Department of Strategic Analysis, Cracow University of Economics, since 2001. Subject of thesis is “Internal Audit System in managing enterprise”. The author of scientific publications focusing on issues of management, internal audit, international business and human resources. Participated in conferences on issues of internal audit and international management. Research interests: strategic management, internal audit of organizations, business management and improvement methods, human resource management.