
The role of internal audit in ensuring the security of public finances in Poland

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Abstract

Ensuring the stability of public finances is important for the solvency of the state, but above all, ensuring that public authorities provide an appropriate level of public services. The stability of public finances depends to a large extent on fiscal policy, and thus constitutes an important impulse for the development of the economy of individual regions. Therefore, an important task is to monitor forecasts of the public deficit and debt, as well as the risks related to the stability of public finances. These tasks belong to the internal audit and include the assessment of activities by public authorities in terms of income, expenses and financial results. In the process of stability of public finances, the role of the internal auditor in the activities of a public finance sector entity is visible. The obligation to conduct an internal audit is specified in the Public Finance Act, and its main task is to influence the processes of improving the functioning of the public finance sector unit. Striving to increase the quality and efficiency of performing public tasks by improving management is the main task of internal audit. The purpose of the audit is to ensure rational and economical management of public finances in connection with the implementation of tasks by all administrators and at all levels of management of these funds. The audit should therefore ensure an independent and objective assessment of the financial management of public funds, according to criteria that guarantee the purposefulness, credibility and economy of their spending. Internal audit ensures a common, uniform system of control of public finances, the same for all entities managing public funds at all levels of management.

Key words: audit, risk, public finance sector unit.

Introduction

Progressing globalization and the increasing scope of economic and financial integration in European Union countries require that the issues of public finance security also be brought to the international (EU) level. Europe is the continent with the highest intervention of the public finance sector in the economy, i.e. the highest taxes and public expenditures in relation to GDP, as well as strong fiscal expansion for many years, resulting in high public debts of most EU countries. The result is an increase in investment risk, more expensive capital and less free access to it, felt especially by less reliable countries, which further reduces the profitability of economic activity in the EU, which is already limited by relatively high public levies.

The audit is presented as an extension of the management function, aimed at diagnosing the situation, as well as preventive, assessment and improvement activities. It is insufficient for internal auditors to identify only possible irregularities. It is necessary to provide management with information preventing the materialization of significant risks to which the organization is exposed and to issue system improvements to improve the effectiveness and efficiency of operations. Internal audit is therefore a tool of modern management, also in the public sector. By examining and assessing the activities of public finance sector units, the audit is intended to support the unit

in achieving planned goals, improving the effectiveness and efficiency of management processes. The task of the audit is to bring added value through a systematic and orderly assessment of the entity's activities and through advisory activities. In management sciences, the issue of increasing the effectiveness and efficiency of organizations is often raised. Therefore, modern management instruments are indicated, i.e. internal audit, aimed at improving the operation of units in the above-mentioned areas. Internal audit functions in organizations where there is also a need for modern control systems, including not only ex post controls, but also ex ante controls.

The main goal of the article is to present the importance of internal audit in the process of ensuring security related to financial management in public finance sector units. The article presents contemporary internal audit as an integrated system and embedded in information and control activities and entity management. The study was carried out using several research methods. The basic ones include the analysis (comparative and descriptive) of national and international legal and professional acts (standards) and the literature on the subject, as well as the method of synthesis and deduction. The assessment of the importance of audit in the process of ensuring the security of public finances was supplemented with the results of surveys conducted in a selected group of local government units in Poland.

Result and Discussion

Organization of internal audit in public finance sector units

Internal audit in public finance sector units was introduced as a result of the amendment to the Act of November 26, 1998 on public finances, made in the Act of July 27, 2001 amending the Act on Finance, the Act on government administration departments and the Act on the Civil Service. The creation of the audit was related to:

- unification of Polish, EU and international standards procedures for auditing and management (internal) control as tools supporting the effectiveness and efficiency of management;
- the need to improve the quality of governance and management in public finance sector units;
- Poland's accession to the European Union; absorption of EU funds;
- the need to increase the protection of public resources and funds, both national and Community, including the rationalization of public expenditure due to meeting the convergence criteria of the Treaty establishing the European Community, as well as developing effects, added value, and increasing the effectiveness of the activities of public finance sector units. The concept of audit is defined in Art. 272 section 1 of the Act of 27 August 2009 on public finances (hereinafter referred to as the Act of 27 August 2009).

As is clear from its wording, internal audit is an independent and objective activity, its purpose is to support the minister in charge of the department or unit manager in the implementation of goals and tasks through systematic assessment of management control and advisory activities. In turn, according to art. 271 section 2 u.f.p. the assessment referred to in section 1, concerns in particular the adequacy, effectiveness and efficiency of management control in a government administration department or unit. The function of internal audit is:

- directing resources to the most priority areas;
- performing work in accordance with professional standards of conduct;
- impartial examination of things that are of real importance to the company;
- providing sufficient and reliable evidence to confirm audit conclusions;
- informing company management on ways to improve internal control;
- working with management and staff to ensure that internal control is in place throughout the organization.

There are many interpretations of the statutory definition of internal auditing in the literature. C. Trepner puts forward a thesis that audit is a new generation of control.

In his opinion, this qualification of the audit accurately reflects its essence. It is true that the audit regulations do not use the word “control”, but “checking” or “verification activities”. But checking is nothing more than the first phase of every control, and checking activities are simply control activities, just named differently. An audit, just like a control, is about reliably determining the actual state of affairs, comparing it with the current state, revealing deviations, their causes and effects, submitting a request to correct errors and improving the assessed (in the case of an audit) or controlled activity, possibly with identifying persons responsible for identified irregularities (in the case of an inspection).

Another interpretation of internal audit is presented by E. Chojna-Duch.

In her opinion, the concept of internal audit comes from the concept of control, but is broader. Internal audit – as a type of activity listed in the Public Finance Act – is a type of control and advisory activities supporting the management of a public finance sector entity. It can be defined as a set of independent (objective) control and advisory activities undertaken systematically in the course of the entity management process, as a result of which the manager of the entity being audited obtains objective knowledge, the so-called rational assurance, and is able to assess the functioning of the entity in terms of its economy, including financial, and control procedures. This position remains consistent with the Public Finance Act of 2009, which emphasizes that the audit is to support the minister in charge of the department or the head of the unit.

However, K. Winiarska formulates a different position regarding the role of internal audit in public finance units. The author is of the opinion that internal audit is particularly suitable for performing advisory activities because it carries out comprehensive audits. If the internal auditor limits himself or herself to audit activities only, it is a waste of resources.

This view is shared by J. Płaskonka. In his opinion, internal audit fulfills all the elements of the control (audit) function, and its main purpose is to independently assess the effectiveness of management and control systems and to develop – and present to the head of the unit – conclusions resulting from this assessment (also of an advisory nature). Internal audit is therefore an independent and systematic assessment of the suitability, application and effectiveness of internal control systems of a given organizational unit. The Act also assumes that the unit manager, on the basis of the internal audit report, has a statutory obligation to take action to remove deficiencies or improve the functioning of the unit.

According to other authors (Grocholski H.), an internal auditor can be called a diagnostician.

The diagnostician views the organization as a set of systems and subsystems created to achieve the goals set by management. It assesses which systems are key to the entity's financial situation and verifies their functioning to reasonably ensure that they are legal and effective. It seems that in the activities of an internal auditor it is difficult to talk about the separation of control and advisory functions. Activities within these two spheres are closely intertwined, which means that it is impossible to perform advisory activities without first carrying out an inspection in a specific scope. Only with knowledge about actual errors, omissions and irregularities (which the auditor obtains as a result of the audit) it is possible for the diagnostician to formulate any advisory conclusions that support the activities of the manager of the public finance unit.

The aim of the audit is to ensure rational and economical management of public finances by all administrators and at all levels of management of these funds. The audit should therefore ensure an independent and objective assessment of the financial management of public funds, according to criteria that guarantee credibility. It was decided that such assurance could be provided by an assessment of public finance management carried out according to the criteria of legality, economy, purposefulness and reliability, as well as openness and transparency. The effectiveness of the audit,

i.e. its impact on the rationalization of public finance management, is based on the assumption that only substantive validity should determine the use of the auditor's comments, conclusions and recommendations and, therefore, any enforcement measures that the audit does not provide for are unnecessary. By introducing the audit, a common, uniform public finance control system was created, the same for all entities managing public funds at all levels of management.

It should also be taken into account that the subject of the auditor's assessment is, according to the Act, management control – based on the criteria of “adequacy, effectiveness and efficiency”. Proper control of the economy of a given entity, which is to be the basis for effective internal audit, requires not only an assessment of the entity's financial operations, but also an examination of the entire management processes and control systems, including decision-making and assessment of the internal control systems operating in the entity. The internal auditor's advisory activities also include proposals presented to the unit's manager aimed at improving its functioning – the new act does not provide for recommendations. Therefore, the literature rightly emphasizes the close connection of internal audit with management control. The assessment concerns in particular the adequacy, effectiveness and efficiency of management control in a government administration department or unit. At the same time, a doubt arose as to whether advisory activities concerned only management control or whether they had a broader character. This doubt seems to be justified by the expectations towards auditing that internal auditing supports the organization in achieving its goals through systematic and consistent activities aimed at assessing and improving the effectiveness of risk management, control systems and organizational management processes.

To sum up, it should be assumed that the task of internal audit is:

- providing the unit manager with objective information about the institution's activities, implemented control systems, perceived risk and the possibility of minimizing (eliminating) it and introducing improvements to increase the effectiveness and efficiency of the unit's operation;
- systematic control of management control based on the criteria specified by the legislator, i.e. adequacy, efficiency and effectiveness.

Management control, in turn, is a much broader category than just comparing the performance (actual state) with the determinants (desired state).

Internal audit is one of the key elements necessary for the proper management of an organization, including a public finance sector unit. According to the definition of The Institute of Internal Auditors (IIA), internal audit is an independent consulting and verification activity whose aim is to improve the operational efficiency of the organization and bring added value to it. Internal audit helps an organization achieve its goals through a systematic and methodical approach to assessing and improving the effectiveness of the organization's risk management, control and management processes. The main elements and objectives of internal audit included in the definition:

- helping the organization achieve its goals;
- assessing and improving the effectiveness of risk management, control and management processes of the organization;
- independent consulting and verification activities aimed at improving the operational efficiency of the organization and adding added value to it;
- independence and objectivity;
- systematic and methodical approach.

The audit involves a systematic, orderly assessment of risk management, control and organizational governance processes, and contributes to improving their operation. It helps the organization achieve its targets by providing assurance on the effectiveness of these processes, as well as through consulting. According to the International Standards for the Professional Practice of Internal Auditing, internal auditing adds value to an organization (and its stakeholders) when it

provides objective assurance on material matters and contributes to effectiveness and efficiency, including control. The internal audit function supports the organization in maintaining effective control mechanisms by assessing and improving their effectiveness and efficiency. Therefore, internal audit assesses whether control mechanisms adequately and effectively respond to risks related to organizational governance, operational activities or IT systems in achieving the organization's strategic goals; credibility and reliability of financial and operational information; effectiveness and efficiency of operations and programs; asset protection; compliance with law, regulations, rules, procedures and contracts.

The importance of audit in ensuring the security of public finances – survey results

The assessment of the importance of audit in the functioning of local government units was based on the results of survey research¹. The survey results constitute an important supplement to the current information gap in the field of internal audit in local government units, because these units are not obliged to submit reports on the functioning of internal audit to the Ministry of Finance.

The results of surveys on internal auditing in selected local government units (municipalities) showed that the organization and activities of the audit were conducted in accordance with the law, and the adopted solutions guaranteed the independence of auditors activities. In most cases, internal audit plans and reports on their implementation were prepared on time and in accordance with regulations. The procedures for preparing, carrying out and documenting audit tasks included in internal regulations should also be assessed positively.

Research has shown that it is becoming more and more common to employ an external service provider (30% of entities have introduced such a solution) instead of maintaining an internal audit unit in the structures (Fig. 1). The results of the analysis indicate that in the case of outsourcing audit services to external entities, the average number of tasks performed by them was lower in relation to the number of tasks performed by auditors employed in the entity. The largest percentage of service providers was in rural communes, and the smallest in urban communes. Service providers may conduct an internal audit only if the amount of income and revenues as well as the amount of expenses and expenses included in the budget resolution is lower than PLN 100 million (Pursuant to art. 278 section 3 ufp.). The employment of internal auditors in the internal audit unit is one of the factors influencing the proper and effective implementation of the internal audit function. The service provider conducting internal audit may be: a natural person who meets the conditions specified in the provisions of Art. 286 of the Labor Code, a natural person running a business, meeting the conditions specified in the above-mentioned, regulations, as well as a civil partnership, general partnership, professional partnership, limited partnership, limited joint-stock partnership or a legal person that employs persons who meet the conditions specified in these regulations to conduct internal audit in the entity. An agreement concluded by a public finance sector entity with a service provider for a period of at least one year should include provisions guaranteeing the conduct of an internal audit in accordance with the provisions of the Public Finance Act. The agreement should also specify how to handle documents, including those in electronic form, created for the purposes of conducting internal audit, so as to ensure their availability and protection against unauthorized dissemination, damage or destruction. (Article 279 of the Labor Code).

¹ The survey was conducted in an interactive form and was made available to local government units in 2020. The purpose of conducting the survey was to obtain basic information on the organization of internal audit in local government units. The survey was completed by 1,964 out of 2,807 (70%) local government units. Respondents provided data and information as of June 30, 2019.

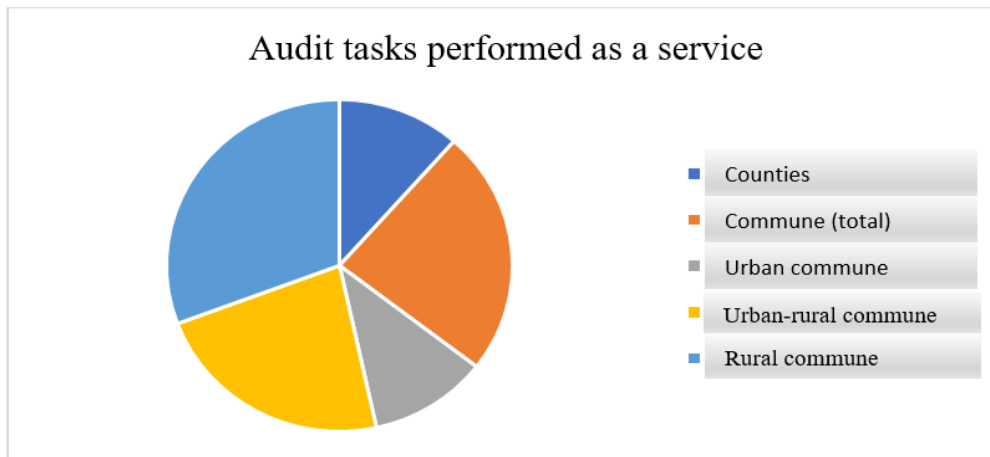


Figure 1 – Audit tasks performed as a service (% of responses)

Source: survey results

In less than half of the local government respondents (42%) – internal audit was conducted by auditors employed under an employment contract. The largest number of full-time positions (internal auditors and people in auxiliary positions) was found in large units, e.g. in city offices with county rights. In the case of urban communes (79%), urban and rural communes (63.2%), auditors were employed on the basis of an employment contract. Taking into account only the level of full-time positions of internal auditors, it can also be observed that the smallest number of full-time positions is most common among rural communes, and the highest in voivodeships and cities with powiat rights (Fig. 2). Almost all marshal offices employ more than one internal auditor. In the case of cities with county rights, over 90% of units employ one or more auditors. In other types of entities, the employment of auditors at a level exceeding one full-time position was rare and occurs in less than 4% of cases.

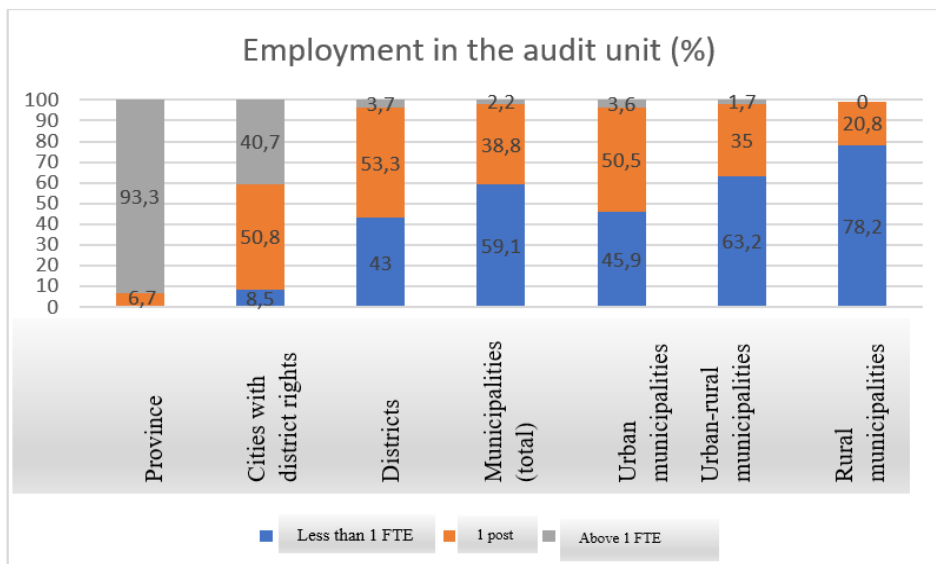


Figure 2 – Employment in the audit unit (% of responses)

Source: survey results

The provisions of law (IFP and the Regulation of the Minister of Finance of September 4, 2015 on internal audit and information on the work and results of this audit, hereinafter referred to as the Regulation) and Internal Audit Standards impose specific obligations on managers of units and internal auditors and assign them specific tasks.

The duties imposed on the unit manager and the tasks assigned to him are as follows:

- ensuring the conditions necessary for the independent, objective and effective conduct of internal audit;
- ensuring organizational separateness of the audit;
- ensuring continuity of internal audit;
- ensuring direct reporting of the audit to the head of the unit;
- cooperation with the auditor/service provider in the preparation of the annual internal audit plan and its changes;
- defining priorities for the audit plan;
- approving (signing) the audit plan;
- granting authorization to conduct internal audit;
- receiving internal audit reports;
- receiving reports on assurance tasks;
- receiving information from the auditee about the method and date of implementing the recommendations and about the persons responsible for implementing the recommendations;
- receiving information from the auditee about the refusal to implement the recommendations;
- making decisions on the implementation of audit recommendations in the event that the auditee is audited refused to implement them;
- receiving the results of checking activities;
- requesting consulting activities and agreeing on their purpose and scope of the audit/service provider.

The vast majority of respondents (over 90%) confirmed that they met the above-mentioned criteria and responsibilities (Fig. 3).

Much more negative responses appeared in the case of the internal auditor (and service provider) applying the Standards in the field of:

- development of an audit card;
- developing procedures for conducting internal audit;
- developing a quality assurance and improvement program;
- conducting self-assessment (for the last year);
- carrying out external evaluation within the last 5 years.

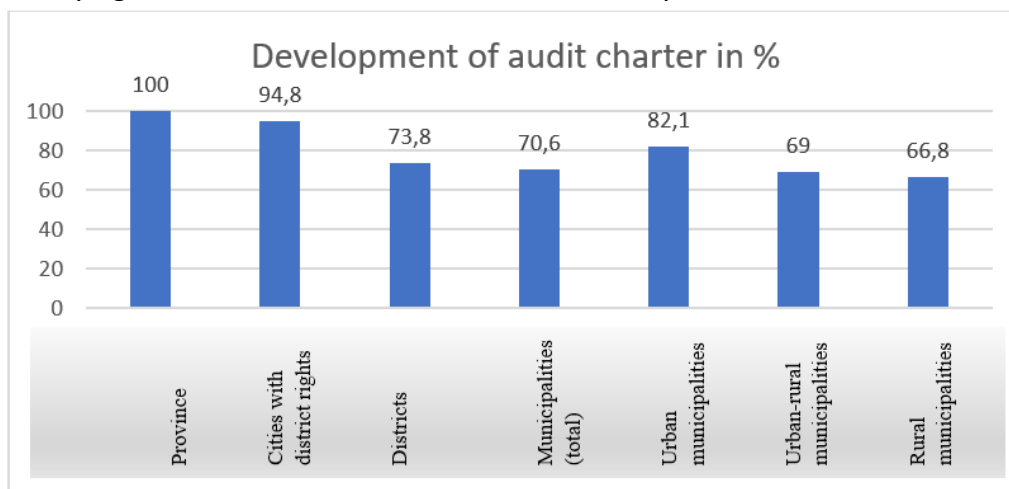


Figure 3 – Development of an audit card (% of responses)

Source: survey results

Providing the conditions necessary for the independent, objective and effective conduct of internal audit also means developing internal audit procedures. Pursuant to art. 282 section 1 of the Polish Financial Supervision Authority, the obligation to ensure such conditions rests with the unit's manager. Article 276 of the Labor Code also states that in a local government unit, the tasks assigned to the head of the unit are performed by: the commune head, the mayor, the city president, and the chairman of the management board of the local government unit. The tasks of local government units in terms of developing internal audit procedures in the surveyed units were mostly properly implemented (Fig. 4). This requirement was complied with by all voivodeship governments (100%), and local governments to a varying extent (cities with county rights – 88.1%, communes – 66%).

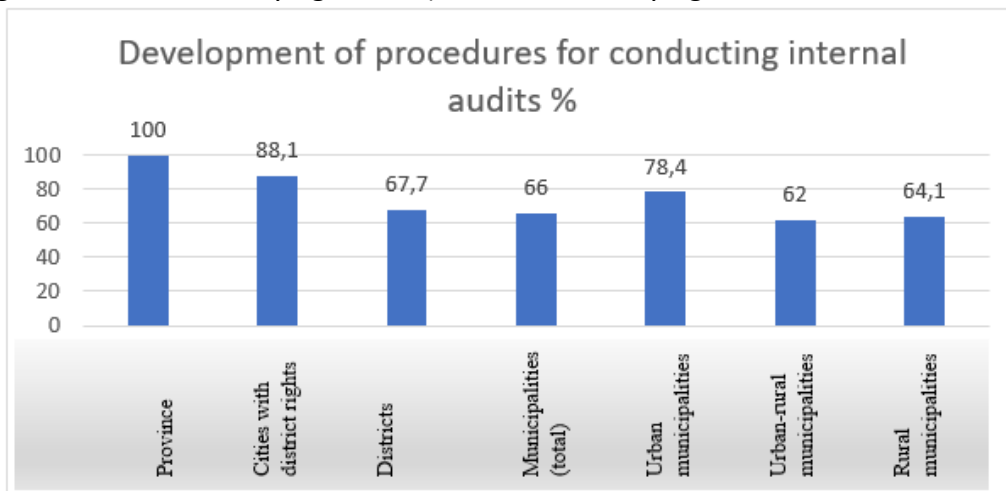


Figure 4 – Development of internal audit procedures (% of responses)

Source: survey results

Pursuant to Art. 283 section 3 of the Polish Financial Supervision Authority, the audit plan is prepared by the auditor/service provider in consultation with the head of the entity. The regulation specifies in §9 section 2, that this plan is signed by persons performing these functions. Moreover, §10 of the regulation states that a change in the audit plan requires written agreement between the auditor and the head of the entity. The survey results confirmed that managers of individual local government units cooperated with the auditor/service provider in preparing the annual internal audit plan and its changes (Fig. 5).

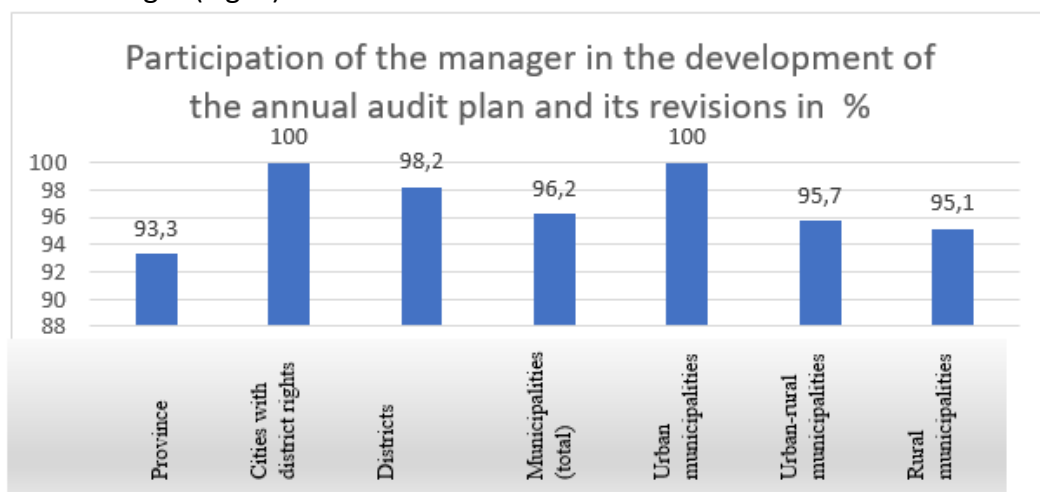


Figure 5 – The manager's participation in the development of the annual audit plan and its changes (% of responses)

Source: survey results

Pursuant to §19 section 1 of the regulation, the auditor submits a report on the task to the auditee and the head of the unit. The survey results showed that the vast majority of unit managers received reports on assurance tasks as well as the results of verification activities (Fig. 6).

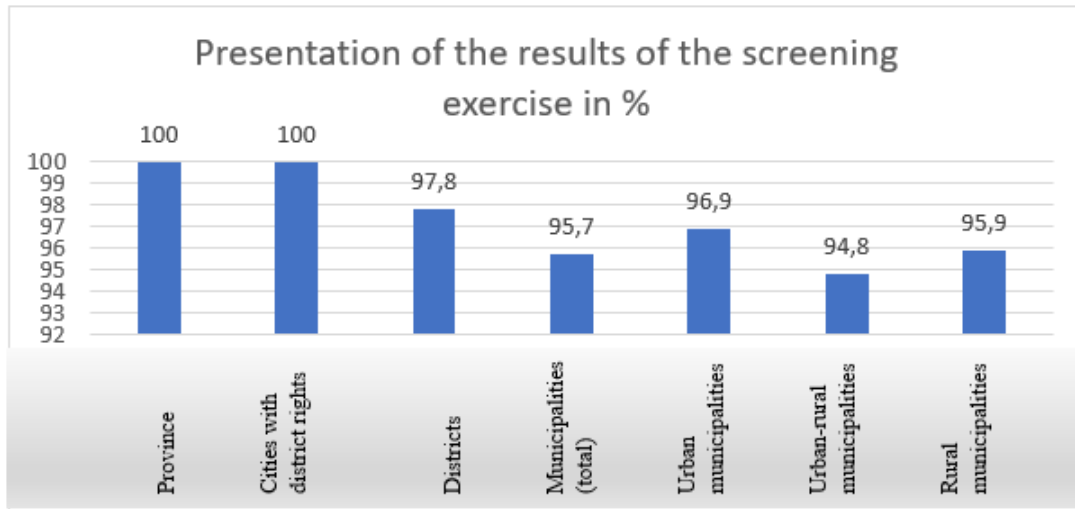


Figure 6 – Presenting the results of checking activities (% of responses)

Source: survey results

The internal auditor may perform advisory activities to support the unit's manager in achieving goals and tasks, at his request or on his own initiative. The purpose and scope of advisory activities are agreed between the internal auditor and the unit's manager. The internal auditor refrains from performing advisory activities that would result in him assuming duties, responsibilities or powers falling within the scope of management of the entity, and informs the entity's manager thereof. The respondents indicated (Fig. 7) that they applied for advisory activities, e.g. in voivodeships (93.3% of responses), in cities with poviats rights (100%), poviats (95.4%) and in communes (94.6%).

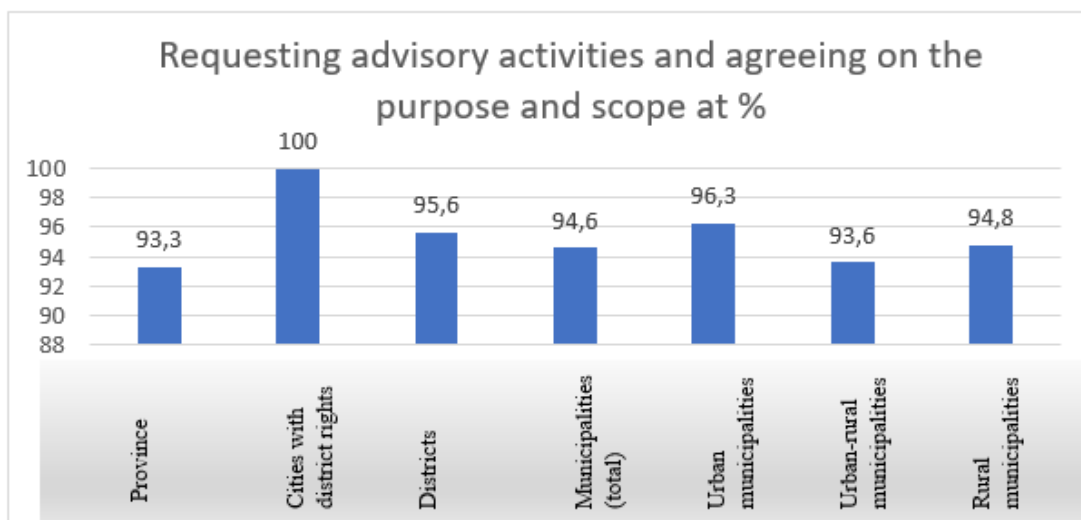


Figure 7 – Requesting advisory activities and agreeing on their purpose and scope (% of responses)

Source: survey results

Pursuant to §19 section 2 of the regulation, the auditee determines the method and deadline for implementing the recommendations and appoints persons responsible for implementing the recommendations, notifying the auditor and the head of the entity in writing. The vast majority of

respondents confirmed (Fig. 8) that the head of the unit received information about the method and deadline for implementing the recommendations and about the persons responsible for implementing the recommendations (if recommendations were formulated).

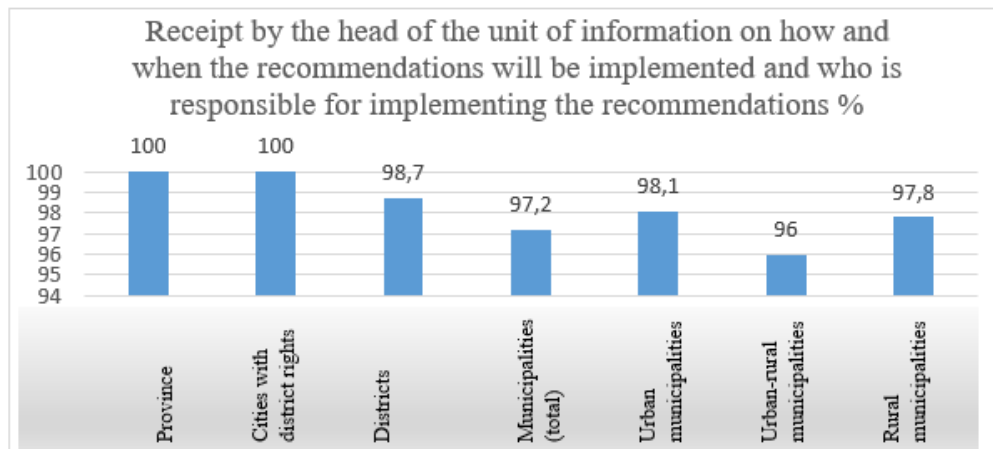


Figure 8 – Receiving information by the head of the unit about the method and date of implementing the recommendations and about the people responsible for implementing the recommendations (% of responses).

Source: survey results

The requirements that an internal auditor must meet are specified in the Public Finance Act (Article 286 of the Public Finance Act). An internal auditor may be a person who:

- is a citizen of a European Union Member State or another country whose citizens, under international agreements or provisions of Community law, have the right to take up employment in the territory of the Republic of Poland;

- has full legal capacity and enjoys full public rights;

- has not been punished for an intentional crime or an intentional fiscal crime;

- has higher education;

- has the following qualifications to conduct internal audit: a) one of the certificates: 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 (CFS) or Chartered Financial Analyst (CFA), or b) passed, in the years 2003-2006, with a positive result, an examination for an internal auditor before the Examination Board appointed by the Minister of Finance, or c) the qualifications of the statutory auditor, or d) two years of practice in the field of internal auditing and holds a diploma of postgraduate studies in the field of internal auditing, issued by an organizational unit which, on the date of issuing the diploma, was authorized, in accordance with separate acts, to award the academic degree of doctor of economics or law. The survey results confirmed (Fig. 9) that the vast majority of auditors (52.5%) passed the internal auditor exam before the Examination Board appointed by the Minister of Finance in 2003-2006.

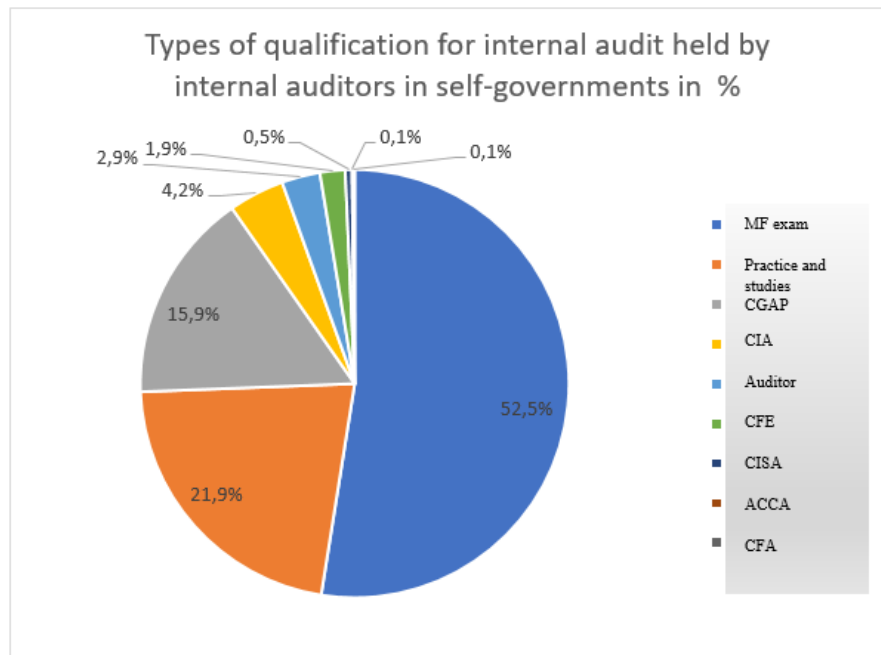


Figure 9 – Types of qualifications to conduct internal audit held by internal auditors in local government units (% of responses)

Source: Source: survey results

Conclusions

The currently applicable provisions of national legal acts regulating internal audit indicate its important purpose, namely supporting the unit's manager in achieving its goals and tasks. Over the ten years of operation of internal audit in the Polish administration, the role of internal audit has undergone modifications and has become more and more similar to the requirements set out in the International

Standards of Professional Practice in Auditing. Currently, internal audit is aimed at supporting management in achieving planned targets through systematic and ongoing assessment of management control, as well as advisory activities. It is also increasingly important to demonstrate the added value of the internal audit function. Taking into account the orientation of public administration activities towards the achievement of planned goals and the introduction of accountability mechanisms for decisions made and actions, the implementation of improvements contributing to increasing the effectiveness and efficiency of the audit function should be considered a priority. The internal auditor in a public finance sector entity, thanks to the legally guaranteed working conditions and methods, should play an important role in improving the quality, efficiency and effectiveness of the activities of public finance sector entities. An important condition for the implementation of the statutorily defined influence of an internal auditor on the functioning of an entity is his knowledge and high qualifications and substantive skills, but also specific psychological and personality predispositions. Without these features of an auditor, it is difficult to talk about building an atmosphere of cooperation and commitment to improving quality and results on the part of audited employees.

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