
Principles of Entrepreneurship Auditing: A Framework for Understanding Audit Efficacy

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Abstract:

Purpose: This study presents a general framework for analyzing factors associated with entrepreneurship audit efficacy. The framework is intended to sharpen one thinking about improving audit process quality and enriching the audit theory better to understand the multiple drivers of audit planning and execution. While the framework has a broad scope, the research focuses mainly on audit requirements presented in auditing standards.

Approach/Methodology/Design: This paper's insights have emerged iteratively by considering both theory and the empirical data based on INTOSAI auditing standards and guidelines and observation of audit organization from the United States, Germany, and the United Kingdom. The abductive reasoning and grounded theory were used during this study.

Findings: The universal principles of audit efficacy were formulated.

Practical Implications: This study continues developing the audit theory and attempts to enrich it by pointing to the audit efficacy factors. From the practical side, the research allows for the formulation of several directional proposals, improving auditors' work.

Originality/Value: This study aims to determine universal factors of audit efficacy and determine whether auditors may create epistemic injustice through their operations.

Keywords: Auditing, management, efficacy, epistemic injustice, entrepreneurship.

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Paper Type: A research study.

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1. Introduction

The role of audit in public life and the economy is widely presented in the literature (Simunic, 1980; Maltby, 1995; Morimoto *et al.*, 2005; Blume and Voigt, 2011; Jeppesen *et al.*, 2017; Cordery and Hay, 2019; Dobrowolski, 2020; 2021; 2021a). It, therefore, seems that all issues have been investigated, and there is no need to continue the research. Meanwhile, the scale of irregularities in business operations and financial scandals in private firms shows that research on the audit process is needed.

This study continues developing the audit theory and attempts to enrich it by pointing to the audit efficacy factors. From the practical side, the research allows for the formulation of several directional proposals, improving private audit companies and public auditors' functioning. Literature studies and observations of audit companies from the USA, Germany, and Great Britain were used in the research. Besides, the available American Government Auditing Standards, Generally Accepted Auditing Standards (GAAS), and International Organisation of Supreme Audit Institutions (INTOSAI) auditing standards and guidelines were analysed.

The paper proceeds as follows: First, the previous studies on the audit concept are presented. After that, the author discusses the research method, followed by analysing factors of audit efficacy. Finally, the author presents conclusions and opportunities for further research.

2. The Audit Concept

The English word "audit" derived from Latin and is associated with the Roman Empire. It means to listen or question (Kraus and Platkus, 2007). It reflects the audit's nature, which is based on asking questions and finding answers to them. The importance of an audit for any organisation is widely presented in the literature (Francis, 2004; 2011; Choi *et al.*, 2010; Carey and Simnett, 2006; Deis, Jr. and Giroux, 1992; DeAngelo, 1981; Jackson *et al.*, 2008; Asthana and Boone, 2012; Knechel *et al.*, 2013; Prawitt *et al.*, 2009; Gopal and Krishnan, 2003; Ghosh and Moon, 2005; Lowensohn *et al.*, 2007; Tepalagul and Lin, 2014; Lennox, 1999; Dobrowolski, 2020; 2021; 2021a; Dobrowolski and Sułkowski, 2020). Nobody questions the importance of audit in improving an organisation's functioning, although many auditing problems, such as auditors' independence or problems with the audit quality, may occur.

It is emphasised that the audit is to check whether and how the plan is being implemented. The same role plays control as a function of the management process (Goetz, 1949; Kast and Rosenzweig, 1970; Koonz and O'Donnell, 1972). The audit provides data enabling the sufficiently early adjustment of the goals set out in the plans according to the requirements set by changing internal and external

conditions. The identification and analysis of the organisation's structure allow those to make the necessary adjustments in separating tasks, powers, and responsibilities among the organisation's components. The relationship between audit and motivation consists of diagnosing the impact of factors to ensure compliance with expectations. Audit by interfering with the course of operations of auditees may disrupt their functioning. For these reasons, it is necessary to ensure the correct organisation of audit activities, distinguished by a high degree of organisation.

As laid down in ISO 9001:2015 Clause 9.2 Internal Audit, an audit is a systematic and independent, as well as documented process, which enables obtaining audit evidence and evaluating it objectively to determine the extent to which audit criteria are met (Biswas, 2019).

One may distinguish between financial audit and performance audit. Financial audits include financial statement and financial related audits. Financial statement audits provide reasonable assurance about whether an audited organisation's financial statements present fairly the financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. Such an audit is also focused on analysing financial statements prepared in conformity with any other bases of accounting requirements (GAO, 2018, pp. 7-8). Financial related audits include determining whether (1) financial information is presented in accordance with established or stated criteria, (2) the auditee has adhered to specific financial compliance requirements, or (3) the auditee's internal control structure over financial reporting and/or safeguarding assets is suitably designed and implemented to achieve control objectives (GAO, 2018, pp. 7-8).

A performance audit is an objective and systematic examination of the evidence to provide an independent assessment of the performance of a government organisation, program, activity, or function to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. Performance audits include economy and efficiency and program audits. Economy and efficiency audits include determining (1) whether the entity is acquiring, protecting, and using its resources economically and efficiently, (2) the causes of inefficiencies or uneconomical practices, and (3) whether the entity has complied with laws and regulations on matters of economy and efficiency.

Program audits include determining (1) the extent to which the desired results or benefits established by the decision-maker are being achieved, (2) the effectiveness of organisations, programs, activities, or functions, and (3) whether the entity has complied with significant laws and regulations applicable to the program (GAO, 2018, pp. 10-11).

According to GAAS, in specific engagements, the auditor may also be subject to other auditing requirements, such as Government Auditing Standards issued by the United States comptroller general (Generally Accepted Auditing Standards). It means that the auditor should follow the audit requirement related to performance audit when assessing public funds' effectiveness, efficiency, and economy. It seems that performance auditing is not reserved only for the public sector. Any reasonable managers want to know how companies' funds are spent and whether they bring value for money, measured by financial indicators and how the effective internal processes are.

3. Material and Methods

Following Strauss and Glaser's arguments (Strauss and Corbin, 1997; Glaser, 1999; Bowen, 2009) and the grounded theory, it was assumed that social reality is best understood by the actors involved in it. The author of this article has been an auditor for 30 years and co-creator of three worldwide audit standards and audit guidelines. It enabled a better understanding of audit reality and requirements. The literature study was enriched by the observation of the daily functioning of three leading audit organisations. The research used the results of the American audit organisation's observations, in which one of the authors of this article spent over seven months.

Moreover, several days of observations of the German audit organisation and more than months of observations of the British audit organisation were used. Besides, the American Government Auditing Standards, Generally Accepted Auditing Standards, and the following INTOSAI standards were analysed:

- ISSAI 100 - Fundamental Principles of Public-Sector Auditing;
- ISSAI 130 - Code of Ethics;
- ISSAI 140 - Quality Control for SAIs;
- ISSAI 200 - Fundamental Principles of Financial Auditing;
- ISSAI 300 - Fundamental Principles of Performance Auditing;
- ISSAI 400 - Fundamental Principles of Compliance Auditing.

This research has some limitations. The author observed how public auditors work, which are members of the International Organisation of Supreme Audit Institutions. Therefore, the author cannot rule out that some private audit firms may work differently than leading public audit organisations. On the other side, it seems that public auditing standards are similar to Generally Accepted Auditing Standards (GAAS) developed and issued by the American Institute of Certified Public Accountants (AICPA) in 1972. This GAAS comprises standards that comply with analysed public auditing standards. Because the author has no evidence that all private auditors in the World follow auditing standards listed above, therefore, due to these limitations, the author needs to show modesty

towards the generalizability of research findings and encourage future researchers to test whether research findings hold in other audit firms in different countries.

4. Research Results and Discussion

4.1 General Audit Principles

The condition for achieving the audit process's efficacy is to meet the principles according to which the audit should be organised. The principle of material truth is one of the fundamental principles of a permanent nature. Its essence boils down to that the auditor should consider all the circumstances accompanying the phenomena under study and strive to make audit findings consistent with the facts. Failure to comply with this principle distorts the sense of the audit. Conclusions and recommendations based on audit findings that do not correspond to the truth will be affected by mistake and will not fulfil their role, as incorrect decisions may be made on their basis.

There are two possibilities. The auditor misleads stakeholders who are convinced that the audit confirmed the correct course of events, or the auditor with the auditee knowingly misleads third parties. In both cases, the result of an audit is presenting an incorrect picture of the auditee, which generate epistemic injustice. Following Fricker (2007) arguments, one may state the testimonial injustice may occur wherein a representative of the auditee receives an unfair deficit of credibility from a stakeholder due to prejudice on the stakeholder's part. Following further Fricker (2007) arguments, one may add that the hermeneutical injustice will occur. Someone (individuals or auditees) has a significant social experience area obscured from understanding due to prejudicial flaws in shared resources for social interpretation, flawed from wrong audit reports.

Another principle obliges using all possible (legally permitted) audit criteria when audit findings are evaluated. Moreover, this rule obliges the auditor to make findings with all the facts and circumstances accompanying a given event. The principle of objectivity is expressed in the reliable determination of the facts and documentation of activities. The audited activities can only be established based on the gathered evidence. The audit conclusion and recommendation must be based on verifiable findings and the research process based on logical reasoning. It means that the facts presented in the audit report must be based on the evidence gathered in the audit files. The discussed principle relates to the need to perform tasks impartially and objectively determine and reliably document the audit results. The duties of impartial performance of tasks result in the obligation to examine circumstances favouring and benefit the auditee. Therefore, it is impossible to present only irregularities, omitting positive actions, distorting the auditee's actual picture (Dobrowolski, 2021a).

The principle of objectivity is related to the institution of excluding the auditor from the audit procedure if there are justified doubts about its impartiality. Another rule, the principle of writing, indicates that the audit procedure should be recorded in writing. This ensures the possibility of reproducing the audit findings and the explanations submitted by the audited regarding specific events' circumstances.

The adversarial principle means equality of the parties involved in the audit process. It means the parties' collaboration in gathering evidence. It is based on the need to ensure the audit findings' completeness and compliance with the actual situation and assume that the audit is open. The consequence of the latter finding is the participation of the auditee in the audit process. Following the discussed principle, the auditee can submit explanations, statements, and reservations to the reliability of audit findings. Besides, there is also the principle of the presumption of innocence of the audited entity (Dobrowolski, 2021a).

4.2 The Factors Influencing the Efficacy of the Audit Process

The audit may disrupt the auditee's functioning. Therefore, it is necessary to ensure the correct organisation of audit activities, distinguished by a high degree of organisation. According to the praxeological directive, an organised audit cycle includes preparation, conducting, and evaluating the audit. The praxeological approach to audit issues indicates the need to analyse the auditor's goals. They are autonomous categories that fall within the audit organisation and come from their environment. The realisation of audit goals requires planning audit activities understood as conceptual activities consisting of the analysis of internal and external conditions for conducting an audit and establishing means and methods of operation adapted to both the formulated goal and the situation in which it will be achieved.

The alignment of means and modus operandi with objectives is a fundamental requirement for smooth operation. To fully understand what is happening and whether all activities are going correctly, one does not need to audit everything. Instead, there is a need to focus audit efforts on those areas of auditees that are highly vulnerable to non-compliance. Besides, the audited issues should be of key importance to the organisation. Such audit selectiveness enables to limit the cost of an audit. The effect of the excessive audit is paralysing the functioning of the auditee. Audit absorbs the audited organisation's management and employees to such an extent that they cannot properly perform their duties. Excess audit prevents any initiative and forces one to function passively, fearing sanctions. The decrease in operational efficiency resulting from the excess of audit intensifies the audit and, as a result, the phenomenon of a vicious circle occurs. The excess audit may result from overestimating its role. Therefore, both overestimating and underestimating an audit are mistakes, leading to atrophies in the audit system (Kuc, 1987).

Audit planning can be perceived both as long-term audit planning and planning a particular audit task. A multi-annual audit plan set out the directions of activities, indicate the key issues that should be audited, and directions for improving the auditor's activities. Among the advantages of multi-year planning for auditors, four can be mentioned: (1) Such planning sets the general course of action; (2) It creates the basis for making rational, day-to-day management decisions; (3) It defines how one operates over an extended period of time; (4) It helps to focus on the organisation's resources and the most important goals.

The strategic plan presents the management's intentions to achieve the assumed level of performance of the entire audit organisation and its individual, organisational units. Such planning makes it easier to develop a concept of action, anticipate problems before they arise, and solve them before becoming too complex.

Audit planning may also be understood as planning the audit process. A preliminary analysis should precede this plan to determine whether to audit a specific area of activity. Such analysis should enable gathering information to increase auditors' knowledge of the audited activity, identifying potential problems, and deciding whether the identified problem requires an audit.

Two possible situations can be identified during the analysis. First, potential problems may not yet be known to auditors. Second, the issue may be very well known, and the auditor does not need to carry out a long-term analysis to plan the audit. The time devoted to the analysis should be the time for the initial formulation of the audit objective and the search for the most optimal audit methods from the point of view of achieving the audit objective. The audit plan should define who, what, to what extent, and what test methods are to be performed. The plan may perceive the need to determine the audit's expected results, and any limitations in access to data, the possibility of interpreting the results. The audit plan should answer whether the auditors have the appropriate knowledge and skills to perform it. It is possible to capture the audit plan by interest groups at this stage, which may lead to epistemic injustice. This conceptual phase, therefore, requires documentation and implementation of the multi-eyes' principle.

At the audit planning stage, the risk of irregularities in the auditee activities should be determined. This will allow the scope of the audit to be determined. Besides, considering the postulate of objectivity, one should plan to examine the reliability of evidence before using it to determine the facts and an alternative methodology of examining whether the evidence will be unreliable. Finally, there is a need to plan the audit results' presentation and determine the procedure's costs. Planning should be carried out within a specific time frame to maintain the audit cost's requirement and, at the same time, the requirement of flexibility and timely audit. The requirement of a written form should be maintained, which allows the

reconstruction of the audit team's proceedings, leading to the establishment of such other audit objectives, scope, and audit methodology.

Extending the scope and enriching audit research criteria, emphasising the fast mode of work and the popularisation of team forms of its performance, require continuous synchronisation of all elements that make up the audit system. The postulate of audit coordination should be considered at two levels, macro-organizational (coordination of audit firms' activities) and micro-organizational (coordination of individual members of the audit team). Coordination at the macro level can be realised by creating a register of actions taken by audit firms.

Coordination at the macro-organisational level is even more important, the greater the independence of individual audit firms in defining their tasks. The lack of this coordination may reduce the audit's overall effect and even make it autonomous. Also, the lack of coordination of the audit team members' activities may disrupt and destroy the result. A necessary condition for the coordination of the team's work is to provide mutual information on how the implementation of assigned tasks is progressing so that it is possible to react to any delays or interruptions on an ongoing basis. The importance of coordination increases as the audit team's structure becomes more complex, making each part dependent on others (Kuc, 1987).

The control (verification) of audit activities is an indispensable activity, considering that in practice, the activities related to the analysis of evidence are intertwined with others, i.e., formulating the goal, planning activities, acquiring resources, and carrying out other audit tasks. First, verification helps establish whether the facts are presented in a reliable, objective, accurate, impartial, and simple manner. Secondly, the conclusions drawn from the verification of audit activities are also the starting point for a more precise definition and development of plans for an analogous audit action in each group of problems. Third, there is sometimes a need to repeat the audit. Fourth, the control of auditors' activities performed by another institution independent in the formulation of assessments and conclusions is an important tool for assessing the audit procedure's impartiality, objectivity, and professionalism. This verification can be referred to as a peer review.

Considering the postulate of reducing the cost of research, audit verification's scope should be differentiated from the significance of its findings for the decision-maker. The point is not to give up the principle of material truth but to define the limits to which a possible inaccuracy is acceptable and does not distort the assessments and conclusions based on the audit findings.

Examining too many issues increases the audit cost and causes "blurring" of information by providing numerous data, often unnecessary from the audit objective's point of view. In favour of specialisation, and thus a narrower scope of

interest of auditors, is the fact that the functioning of companies being the subject of their research is characterised by a high degree of specialisation. Audit of a small scope of the subject, specialised undertakings and processes can provide a deeper, comprehensive picture of the issue in a relatively short time. However, there is a risk of too narrowly presenting the issues, thus ignoring the connections with side phenomena, which impact the course of the issues under study.

Conducting an audit in a narrow scope often requires specialist knowledge. It is not easy to accurately assess the program of building a nuclear power plant with only a legal education. To ensure the broadest possible view of the audited scope of reality, audit teams should be appointed, gathering various specialities representatives. Therefore, it can be concluded that the factor of audit efficiency is ensuring the interdisciplinary nature of the audit team. This interdisciplinarity is indispensable when one of the auditors' objectives is the fight against the pathologies of public life, such as waste, abuse, and corruption.

Another fact speaks for the interdisciplinarity, and more broadly, the separation in an auditing company's organisational structure, of groups gathering specialists from various fields and disciplines of science. Investigating an activity regulated by legal norms requires knowledge of these norms and the ability to use legal regulations. This, in turn, requires the adoption of organisational solutions within the proprietary company that ensure a full understanding of a complex legal system. In this way, one reaches another efficacy factor which is the competence of auditors. The appropriate level of qualification of the audit staff is a condition for achieving efficacy by audit firms.

The audit should be carried out in a competent manner, which means the ability to properly perform the audit in terms of its content, organisation, etc. and ensure the audit activity's expected results. It is not only about knowing the regulations governing the powers and duties of auditors. This includes auditors' expertise and therefore knowing the subject of the auditee's activity. The incompetent implementation of the audit causes its low quality. An incompetent auditor will not analyse difficult problems. This, in turn, leads to general assessments and avoids negative assessments for fear of reservations, and, consequently, leads to a superficial audit, which does not give a full picture of the auditee's actual activity. Auditors must, therefore, constantly improve their knowledge and gain new experience.

The key activity in the audit process is to know the facts. The use of inappropriate research methods excludes the possibility of obtaining a correct and objective picture of the reality being audited and, consequently, leads to incorrect conclusions, which depreciates the audit itself and its result. The reason may be a reformulation of the audit. It is a situation in which the measure used to assess an activity's compliance with the pattern becomes the sole basis for making decisions. Thus, what matters to auditors is not the actual impact of action but formal

indicators. For example, it examines whether the institution has developed an action plan.

However, the feasibility of this plan and the effects of poor planning are not investigated. Another reason may be the insufficient formalisation of the audit, and therefore the lack of measures and the discretionary assessment of the auditors' facts. This situation becomes dangerous for two reasons. First, the real picture may be distorted. Secondly, the institution's management may focus its attention not on the action but the auditor's person and try to win the auditor's favour by various methods. Hence, one step to corruption.

It is also a dysfunction of the audit to give too much importance to easily measurable matters only. This problem occurs because it is much easier and faster to investigate quantifiable matters. For example, employee turnover rates are often evaluated and not at all or little is checked to see if the company still has employees with the highest qualifications. As a result, the audit system may focus on relatively smaller matters at the expense of the organisation's more important goals. Another audit error is related to its scope. The auditor may tend to over-emphasise short-term factors at the expense of long-term ones. This is because long-term performance is more difficult to predict than short-term performance.

Auditors should spend the funds allocated to audit activities sparingly. This postulate is difficult to measure because the assumption of the dependence of comparing measurable benefits from audit concerning expenditure on audit may lead to hunting for audit results. Difficulties in determining an audit's cost-effectiveness should not justify and exempt the audit firm's management from the postulate of saving expenditure on audit and full use of the existing audit potential. This remark is valid, particular in the case of public auditors.

The audit cannot be limited to comparing the actual state with the pattern. It should also evaluate the pattern itself. Therefore, there is nothing to prevent auditors from pointing to inaccuracies in the law or loopholes. Such activity, however, requires the possession of specialised groups of auditors enriched with the experience of lawyers employed in audit firms or cooperating with audit firms.

During the audit, the auditor should predict a deviation from the pattern or incorrect patterns and the effects of actions based on incorrect patterns and predict the possibility of errors resulting from failure to consider certain factors. Such an audit fully performs its preventive function and thus counteracts unfavourable phenomena, preventing potential losses, not only financial but also non-material ones, such as demoralisation resulting from the lack of respect for formal institutions.

The audit must be flexible, i.e., adapt to the changes taking place, and be accurate and up to date. Accuracy means basing your audit results on reliable information.

Appropriate audit methods ensure the reliability of this information. The audit should provide reliable information quickly when it is needed in the decision-making process. While the term "fast" is imprecise, its meaning is clear: the sooner, the better, since it means less waste. An efficiently operating audit performs the assumed tasks and performs planned activities in the shortest possible time while exercising maximum diligence for the completeness and comprehensiveness of the analysis and assessment of the audited entity's activities. Therefore, it is not easy to consider a correct operation when several months pass from the moment of the audit to the preparation and publication of the audit report. It is too long to use the audit findings to improve the system under study.

Speed of action cannot, of course, be considered purely in terms of technical aspects. Speed of action cannot mean performing a complex audit in a few days. On the one hand, it means carrying out audit activities without undue delay, following the adopted plan, under the applicable procedures, and on the other hand, it means the speed of reacting to the emerging needs to cover specific areas of activity with audits. The audit should be up to date. This is achieved, among others, by the organisation of meetings during the audit. They allow for the analysis of the audit's current course and identify issues requiring research, which may have been omitted at the planning stage or may not have occurred.

One provides for the organisation of meetings after the end of the audit. Their main goal is to discuss the reasons for the identified dysfunctions and the resulting conclusions for undertaking improvement measures by the auditors and the audited persons. One also provides for obtaining information on how to implement audit recommendations. It seems advisable to create an IT system for verifying such information sent by the audited. Certainly, such a monitoring system would mobilise the audited and the auditors, if only by the fact that it would have to exercise due diligence in the accuracy of formulating audit recommendations.

5. Conclusion

The audit is an overly complex undertaking that, when properly carried out, benefits the auditees and stakeholders, and when the audit is poorly carried out, it has far-reaching consequences. From the perspective of each auditee, two issues are of key importance. First, how did the auditors in the conceptual phase operationalise the audit objectives? Second, whether auditors use data and method triangulation to ensure the accuracy and reliability of audit findings? Audit standards require auditors with honesty, integrity, objectivity, and other qualities of efficient operation.

Although the audit standards indicate the need to ensure the parties' equality to the audit procedure, it seems justified to consider introducing solutions that would allow the audited and other interested parties to verify whether the auditors comply with the auditing standards. The audit consequences are too serious for society and

business to rely solely on the auditors' promises. It seems that the concept of "check and trust" should apply both ways.

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