



Enhancing Stakeholder Confidence: Auditing Management Integrity, Accountability and Tone at the Top

Introduction

Major global developments such as the economic and financial crisis, corporate failures, and citizen centred public service delivery have brought to the fore the fundamental need for consistent ethical and professional behaviour by an entity's executive. In essence, management integrity, accountability and setting the right tone at the top are essential requisites of good governance. They enable public and private sector organisations to achieve optimal results from existing resources, fulfil their objectives, create a harmonious work environment, and comply with rules, regulations and accountability requirements.

Public sector organisations form the underpinnings of economic, social and environmental development and should be a beacon of accountability and transparency. In order to achieve the latter objective, the performance of public sector entities is subject to scrutiny by a number of internal and external stakeholders such as Parliament, Government, Supreme Audit Institutions, Non-Governmental Organisations, employees, the media, citizens and contractors. Stakeholders want to feel confident that public sector entities are effectively and ethically managed, and are yielding the desired results. They would also like to feel engaged in the activities of public sector organisations and lend support to management in achieving their objectives.

It is the responsibility of public sector organisations to build stronger relationships with their stakeholders. This aim could be achieved through the timely and transparent statement of entity developments and results and by embarking on a competitive growth strategy that is clearly communicated to stakeholders. Such a strategy is dependent on effective cost control, citizen centredness and improving operational efficiency and effectiveness.

It might be opportune at this stage to distinguish between various attributes that build stakeholder confidence. Such attributes of public sector entities include, for instance:

- a clear mission and vision;
- the development, monitoring of, and reporting on key performance indicators;
- risk management processes;
- attraction and retention of key talent; and
- effective management and leadership processes.

Public sector organisations are to have a clear and compelling mission and vision that imbue the organisation with a sense of purpose and energy and form the basis for the formulation of strategic objectives. Stakeholders are to be aware of such mission, vision and strategic objectives.

Moreover, the development of key performance indicators to serve as a yardstick to measure and monitor performance is critical to any public sector entity. Such indicators would also facilitate decision making, and enable full transparency with respect to the reporting of financial results and of environmental and social impact of the public organisation.

High performing public sector entities incorporate risk management tools within their business planning processes with detailed procedures regarding risk analysis, the treatment of risk, and risk reporting. These procedures would assist in safeguarding the long-term reputation of the public entity among stakeholders.

An effective public sector organisation attracts and retains key talent. The public organisation improves its workforce skills through adequate training and self-development, provides an attractive remuneration package that rewards high performance, and maintains an open and honest communication policy with its employees.

Successful public entities are directed by effective and competent managers who excel in professional judgement, communication and leadership skills. Such managers set the right tone at the top, are accountable and motivate staff to achieve their best level of performance.

Management Integrity

The behaviour of public sector employees and management is regulated by a code of ethics. All public servants are to act with integrity, setting aside personal profit and gain, and working in the public interest. Integrity is defined by the Collins World English dictionary as “adherence to moral and ethical principles, having soundness of character, and acting with honesty.” Employees of public entities are to avoid at all costs the following integrity violations as developed by Huberts (1998: 28-30):

- Corruption
- Fraud and theft of resources
- Questionable promises, gifts or discounts
- Conflict of interest
- Abuse and manipulation of information
- Discrimination and harassment
- The waste and abuse of organisational resources
- Misconduct at leisure

Managers should be honest, of good character, truthful, and trustworthy. They should respect laws and regulations, including those governing health and safety, fulfil social obligations, and act with fairness and justice. They must also demonstrate professional behaviour and good judgement.

Why audit management integrity

Audits of management integrity are carried out to determine whether the essential components of an effective integrity strategy, such as the one identified by Lynn Sharp Paine (1994: 112), are in place at the public sector entity. Such elements include:

- The guiding values and commitments make sense and are clearly communicated.
- Company leaders are personally committed, credible and willing to take action on the values they espouse.
- The espoused values are integrated into the normal channels of management decision making and are reflected in the organisation's critical activities.
- The company's systems and structures support and reinforce its values.
- Managers throughout the company have the decision-making skills, knowledge and competencies needed to make ethically sound decisions on a day-to-day basis.

First of all, the auditor is to ensure that the public sector entity has clear policy guidelines promoting ethical values and commitments, whilst prohibiting integrity breaches. Such guidelines are to be communicated to all staff of the public organisation. They are to comprise an analysis of risks to integrity and a review of areas susceptible to corruption; the drawing up of a code of conduct, a conflict of interest policy, and a gifts and gratuities policy; post employment confidentiality agreements; and organisational measures safeguarding integrity such as job rotation.

Moreover, the auditor is to ascertain whether management leads by example, is personally committed to ethical values and is willing to take action by promoting ethical behaviour and sanctioning improper conduct. The auditor is also to determine whether managers throughout the public sector entity have the decision-making skills, knowledge, and competencies needed to make ethically sound decisions on a day-to-day basis.

Management is in a position of trust and the auditor needs to determine that each director is in fact placing his or her fiduciary obligations above personal interests. For instance, it is essential that management avoid conflict of interest situations. If a conflict exists, management should disclose such matter to the parties concerned. Management is also to avoid other integrity violations as described above.

Another objective of auditing management integrity is to assess whether ethical values are integrated within the organisation's critical activities. The auditor needs to establish whether the entity's key operations such as resource allocation; procurement, contract management and payment; the recruitment, remuneration and promotion of staff; and performance measurement are carried out in an ethical manner. S/he is also to assess whether the company's systems and structures, such as information systems, the design and operation of internal controls, and quality assurance systems reinforce ethical values.

Auditing management integrity enables organisational learning by identifying the strengths and weaknesses of integrity policies, the identification of vulnerable areas, and an assessment of areas

where integrity is/is not being achieved. This promotes knowledge management within a public sector entity and across the public sector.

Methodological limitations

In practice, the audit of management integrity may prove to be an arduous task. An auditor might attempt to judge management integrity by assessing management's attitude towards performance measurement and reporting, controls, and the external audit, as well as their reputation within the community (Dwight Sneathen, Kizirian, Mayhew: 2003: 9).

However, very often, the main objective of an audit is to assess whether systems are being operated in accordance with the principles of sound financial management, and not the audit of management integrity directly. The scope of most audits therefore, covers just one aspect of management integrity.

Moreover, there might be instances where management would be complying with rules and regulations, however, its behaviour would still be unethical especially when it results in the squandering of organisational resources. For example, a director might use his entitlement to a free telephony service to make excessive personal phone calls that amount to a hefty bill. The claim of such a high amount may be legal but is unethical.

Reporting challenges

Local legislation makes no direct reference to the requirement of auditing management integrity in its entirety. However, such legislation stipulates that *"any serious irregularity discovered by the Auditor General in a Government department or office, or in a body subject to his audit, shall be brought to the notice of the Minister responsible for that Government department, office or body by the Auditor General."*

Therefore, whenever NAO encounters a situation of an integrity breach, the Office has to decide whether to report the deficiency to the Minister, publish this result in a report, or both. The course of action taken would be determined following consideration of the public interest and accountability requirements.

In addition, the NAO has to ensure utmost objectivity when reporting on integrity violations. It should report such instances in a clear, transparent and unequivocal manner and ensure that they are based on sound and reliable evidence.

NAO Malta Example

NAO Malta has encountered instances of potential management integrity breaches in the performance of its duties. For instance, a Chairman of a public corporation had declared his conflict of interest in the adjudication of a particular project since in his private capacity he had business links with the local company entrusted with civil works in one of the bids under consideration. However, prior to this, he had appointed the members on the evaluation and adjudicating committees responsible for the evaluation of tenders. The Chairman, however, failed to inform his Minister to approve or otherwise the

appointment of these Committees following his (Chairman's) declared conflict of interest. The local company with whom the Chairman had declared having professional connections was actually sub-contracted the civil works of this tender. This created a perceived or potential conflict of interest. The Chairman of the corporation eventually resigned to take up a post with a foreign company. However, the Chairman stated that his resignation was unrelated to the above conflict of interest.

The audited entity did not agree with NAO's assessment in relation to the Chairman's conflict of interest. The Chairman stated that he had appointed the Evaluation and Adjudication Committees in line with prevailing practice, which had been in place for several years. This notwithstanding, he affirmed that he always kept the responsible Ministry informed of the appointments being made and any subsequent amendments. This assertion by the Chairman was however, not substantiated by evidence.

In a supplementary investigation, NAO countered the above arguments by quoting the relevant legislation and reiterated that the steps taken by the Chairman to eliminate the grounds for the conflict of interest were not sufficiently effective, consisting solely of a declaration of the conflict and the subsequent distancing from matters related to the tender. In NAO's opinion, the Chairman of the public corporation in question failed to "avoid any actual, perceived or potential conflict of interest at all costs."

Accountability

A culture of accountability must permeate throughout the public organisation. Such a culture is to be instilled from the top to the bottom ranks through the establishment of adequate performance measurement systems that define clear results within the entity and who was responsible for achieving those results.

Perhaps, at this stage, it might be worthwhile to examine the definition of accountability. INTOSAI has defined public accountability as:

the obligations of persons or entities, including public enterprises and corporations, entrusted with public resources to be answerable for the fiscal, managerial and programme responsibilities that have been conferred on them, and to report to those that have conferred these responsibilities on them.

Annex 2 to INTOSAI GOV 9100 standard titled "Guidelines for Internal Control Standards for the Public Sector" defines accountability as:

- *the process whereby public service bodies and the individuals within them are held responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance.*
- *duty imposed on an audited person or entity to show that he/it has administered or controlled the funds entrusted to him/it in accordance with the terms on which the funds were provided."*

The OECD also provides a definition of accountability. It states that the term accountability is: “a government policy or management concept that means politicians and public officials

- i. have to respond periodically to questions concerning their activities (answerability) and
- ii. must be held responsible for the exercise of the authority provided to them.”

For effective accountability, clear lines of responsibility must be firmly established and consistently maintained. Accountability measures should address three questions: accountability by whom; accountability for what; and accountability to whom. To ensure that accountability is properly enforced, there is a need for predictable and meaningful consequences related to performance. In the public sector, accountability of individual officials, within their organisation and to external controlling bodies, is applied most often to how money has been spent and what results have been achieved. Crucial too in democratic systems is the general accountability of Ministers to Parliament and to the public at large.”

Auditing the mechanisms to ensure management accountability

Management accountability is to be safeguarded through the operation of various mechanisms. Such mechanisms are to be integrated in all of the public entity’s policies and procedures and at all levels of decision making. The Global Accountability Project (GAP) framework promoted by the One World Trust¹ (2005) provides for four dimensions of accountability that are to be implemented by management if accountability is to be ensured. These include:

1. Transparency
2. Participation
3. Evaluation
4. Complaint and Response Mechanisms

Transparency

The management staff members of public sector entities are to be open about their activities and operations. They are to provide information on such processes and give an account to stakeholders on their performance, assisting the latter in making informed decisions about the entity.

Participation

Management is to comprehend the needs of key stakeholders and therefore should establish mechanisms that encourage stakeholder input in the public entity’s decision making. Stakeholders’ views are to be incorporated as much as possible into organisational strategies and policies. Such inputs are to lead to marked enhancements in the performance of the organisation.

¹ The One World Trust is an independent charity that conducts research, develops recommendations and advocates for reform to make policy and decision-making processes in global governance more accountable to the people they affect now and in the future, and to ensure that international laws are strengthened and applied equally to all.

Evaluation

Management is accountable when it monitors its progress against goals and objectives and reports on the process. This should result in a learning process for the public sector entity by encouraging it to achieve agreed standards and targets and enabling it to make improvements in its policies and procedures.

Complaint and response mechanisms

Another mechanism to ensure management accountability is the institution of complaint and response procedures. Thus, stakeholders would be able to lodge complaints, query a public entity's decision or action and receive an adequate response within a reasonable timeframe. This would enable stakeholders to hold management of the public entity to account.

The audit of management accountability includes a review of each of the above. In order to be effective and accountable, management is to implement the above four dimensions to accountability. Accountability is to be integrated into all the entity's operations and activities and must be reflected in the entity's timely response to stakeholders' concerns and needs. Management is also to be committed to plan and implement accountability mechanisms and measures.

Holding management to account

Stakeholders of public entities, including external auditors, hold management to account for their decisions and actions. The former evaluate management's commitment to converting governance and strategic directions into results and performance. They also determine whether public entities have developed a culture of strong public service values and ethics and a policy of continuous learning, innovation and change. They also assess whether management excellence has been achieved in the areas of policy and programmes, people management, citizen-focused service delivery, risk management, stewardship and accountability.

Challenges of auditing accountability

NAO Malta encounters a number of challenges when auditing management accountability. The following constitute some examples of such challenges encountered from the auditee side:

- Unclear lines of responsibilities.
- The unavailability of sufficient resources that prevent the achievement of organisational objectives.
- Limited capability to plan and manage contracts effectively.
- Weak implementation of risk management techniques in certain sectors within the public administration.
- The need for increased communication and collaboration between the various stakeholders involved in projects and in the operation of public entities.

- Investment in cost-effective information technology, performance management and accounting systems not always being sufficient.
- Inadequate enforcement of rules and obligations, especially procurement regulations.
- Instances of deficiencies in internal controls.
- Lack of comprehensive standards and procedures to promote good practices in public entities.

A number of challenges to audit management accountability are also faced at NAO level. For instance, local legislation stipulates that any serious irregularity discovered by the Auditor General in a Government Department, Office, or public entity is to be brought to the notice of the responsible Minister by the Auditor General. The latter may also recommend that the Minister surcharges against that person involved the amount of deficiency or loss or improper payment resulting from non-compliance with the relevant legislation.

Auditors encounter other problems when auditing management accountability at NAO level. At times, insufficient and incomplete documentation and evidence is submitted to the Office and/or inconsistent information is provided by different officials within an audited entity. This may result in insufficient audit evidence on which to base conclusions on accountability.

In other instances, NAO observations are not readily accepted by the audited entity resulting in the lack of immediate implementation of the necessary changes to the administrative, financial and operating systems by the public entity following NAO's review.

At other times, certain other difficulties, such as unclear lines of responsibilities, lack of staff and resources, vacant management posts, and the lack of standard operating procedures render the audit of management accountability a more complex task.

NAO Malta Examples

At this stage, it might be pertinent to include a few examples of auditing management accountability undertaken by NAO. In the majority of cases, NAO encounters cases of weaknesses in internal controls. For instance, a review on personal emoluments at particular Departments revealed various shortcomings. These related to incorrect salary payments, incomplete and/or not updated records, specific procedures not backed up by official regulations, certain provisions not being complied with and lack of control over particular administrative procedures.

Compliance audits in relation to Contractual and Professional Services in a number of Departments revealed shortcomings relating, *inter alia*, to the following:

- No agreements with service providers and/or procurement regulations were not followed.
- Commencement of service prior to approval or formal contract.
- No formal extension of existing agreements.
- Amounts charged by service providers not verifiable.
- No tax invoices or fiscal receipts attached to Payment Vouchers.

Examples such as the ones above often reflect lack of timely action taken by management to address control and compliance issues, which may result in accountability issues.

Tone at the Top

Relevance of leadership to stakeholder confidence

Organisations that cultivate good relationships with their stakeholders demonstrate strong leadership skills. Such entities possess strong organisational vision and direction, and are those with the greatest clarity of purpose.

Moreover, in order to further enhance stakeholder confidence, good leaders set the right tone at the top by continuously improving their corporate governance arrangements and by promoting a higher level of transparency and accountability. The latter values are embedded at all levels of the organisation. It is indeed critical for senior leadership to act as role models through their behaviour, actions, and words to encourage and motivate staff at all levels of the organisation to act likewise.

Governance

Effective governance is a key component of an entity's success. Top Management is to consistently act with integrity and is to ensure that employees at all levels of the organisation comply with a documented code of ethics. Such code is to include guidance on procurement processes, as well as incorporate mechanisms to encourage employees to report instances of illegal or unethical conduct. Integrity and accountability are to be the cornerstones of the work ethic, and all employees are to comply with professional standards applicable to their profession and jobs which they undertake. Management is also to project an image of integrity and lead by example. "Practising what they say" enforces the ethical values and standards of the entity.

Policies and Strategies

Public entities are to implement clear policies and strategies that promote good governance, accountability and transparency. Such policies and strategies should be backed by systems and processes that help shape a culture of integrity.

For instance, human resource policies should ensure that competent people with the right aptitude and integrity are employed. Public organisations are to be aware of their employees' strengths and skills in order to obtain maximum benefit from their varied expertise. They are also to reward and recognise good behaviour, and take action, openly and transparently, to address poor conduct.

Another key to effective governance is to instil a focus on results. Top management takes decisions on the basis that their actions lead directly towards improved results. By building on previous successful experiences, management gradually creates a foundation on which to base organisation-wide performance improvement. Moreover, ensuring that goals and objectives are met without engaging in dubious operational practices is a laudable endeavour.

Open communication is also to be encouraged. A lack of transparency may lead to fear, distrust and even confusion. Although some information may not be communicated for confidentiality purposes, the sharing of as much information as possible is prudent and appropriate and enhances stakeholder confidence.

Challenges of Auditing “Tone at the Top”

Auditing “Tone at the Top” presents a number of difficulties for NAO auditors stemming from both the auditee and NAO perspectives.

Auditee perspective

One deficiency encountered by NAO is the lack of clear strategies by Government Ministries, Departments and other public entities to implement government policies and objectives. This may lead to an uncertain tone at the top resulting in delays in achieving the expected outcomes of government policies and initiatives.

In some public entities, the respective responsibilities of management and staff at various public entities are unclear. Furthermore, there are instances where public entities may lack qualified or experienced staff. In such cases, management lacks the necessary tools and resources with which to effectively carry out its duties and hence is unable to discharge its leadership function sufficiently.

There are also cases where new management in a Government Department or Office inherits systems with deficiencies that are difficult to rectify. Moreover, there is an ever increasing public demand for professionalism and accountability from top management. Managers of public enterprises are thus under increased pressure to consistently improve upon their performance.

In addition, fast changing local and international developments as well as binding EU commitments arising from new EU Directives and Regulations place additional responsibilities and burdens on management in terms of increased workload and duties. Ministries, Departments or public entities concerned need time to adjust to their new responsibilities and hence auditors are to take this into account during audits.

All the above, in many instances, render the audit of the tone at the top a more difficult and challenging task.

NAO perspective

An inherent limitation imposed by legislation is that the NAO cannot go into the merits of any policy or objective of any Government Department, Office or body.

Moreover, Ministries, Departments and Public Entities are normally audited rather than Leadership ‘per se’. Leadership is audited in the context of whether existing strategies are actually being implemented, whether targets are being reached, whether rules and regulations are being adhered to, whether adequate management information systems exist, whether internal controls are being appropriately

implemented, and whether the public is satisfied of service being given by relevant entities. The Audit of 'Tone at the Top' is therefore indirectly carried out.

NAO Malta examples

In the report titled "Road Surface Repairs on the Arterial and Distributor Road Network", NAO noted a number of shortcomings with regards to the inspection system used in identifying road surface defects. NAO considered the maintenance of an updated and reliable database of the defects in this road network as a strategic priority for the public entity responsible for road surfacing repairs. In view of this, NAO urged the entity concerned to consolidate and standardise the inspection and documentation process as a means of planning its work interventions in a more ordered manner. Thus NAO in this example has aimed to strengthen the management processes of the entity concerned.

NAO's principal recommendation in the report "Achieving a Healthier Nutrition Environment in Schools" related to the instatement of a policy governing and regulating the school nutrition environment. Relying on the initiative of individuals, or particularly motivated schools certainly did not address the prevailing situation of childhood and adolescent obesity within schools in a comprehensive manner.

Moreover, in relation to the above study, NAO expressed concern regarding the lack of an active and present coordinating body concerning school nutrition. NAO was of the opinion that only when the existent policy-related constraints and issues would be resolved, can the required coordinating body come into effect. Such an organisation would effectively streamline adopted internal school policies, initiatives and other aspects of the nutrition environment within schools, whilst being recognised as the official focal point addressing all concerns relating to the subject matter. The above has resulted in the absence of a clear strategy in relation to school nutrition.

In an investigation of a company responsible for the management of the Customer Care and Billing functions of two Corporations, NAO noted that the company had deficiencies in three key dedicated functions, namely Customer Care, Human Resource Management and Revenue Assurance. The findings reflected weaknesses in the management processes of the company.

An IT audit at the Government Department responsible for Social Security Payments and Benefits identified shortcomings relating to IT Security, including the lack of a risk assessment and Disaster Recovery Policy. This was indicative of a weak management processes in the above Department.

Conclusions

Enhancing stakeholder confidence in the economic, efficient and effective running, as well as proper accounting, of central government and public entities is crucial in ensuring a nation's success. One way of ensuring stakeholder's trust is through the strengthening of audit processes and procedures in relation to the review of management integrity, accountability and leadership, taking into account methodological limitations and reporting challenges that it may need to address.

Moreover, stakeholder views and citizen focused areas are to be taken into account when selecting audit areas by Supreme Audit Institutions. SAIs need to be consistently aware of public concerns in

relation to the public sector when planning and carrying out audits. Attention to public concerns should constitute one of the key elements of the strategic planning processes of SAIs.

This paper concludes that stakeholder confidence in the management and administration of public entities can only be maximised if strong and robust Supreme Audit Institutions are in place and functioning effectively. These institutions value ethical behaviour, accountability and the right tone at the top highly in their list of priorities both with respect to their performance and in the case of the organisations they audit.

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