

# The Experience of Internal Audit in the Assessment of Ethics

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26 November 2015

# Background

- Public trust in business and the public sector not good - following a series of scandals, fundamental changes called for across sectors, including media, food, retail, health, banking, government, etc, to restore trust
- 2014 Ipsos Mori survey found that c40% of those surveyed believed that companies were 'not very' or 'not at all' ethical in their behaviours!
- Responsibility for corporate ethics lies with those in the boardroom! Boards and executive management have prime responsibility for defining and analysing organisational culture by promoting good ethics and values and behaviours
- IA is uniquely placed to give assurance to those in the boardroom - can provide confidence that there is a strong commitment to good conduct and that it is translated into daily behaviours!
- New standards bodies set up to improve behaviours

# What is Culture?

- Culture = the way we do things around here!
- Culture = organisation's values and how these are translated into everyday actions  
[NB it is the gap between these two that is important!]

# The Role of Internal Audit

- IA's role is to assess and evaluate the extent strategies, processes, eg performance management, remuneration, etc, actions, eg decision making, and 'tone at the top' are in line with the values, ethics, risk appetite and policies of the organisation
- IA can assist the board in judging whether measures put in place to change culture and thus behaviour are actually working  
[NB Auditing culture and its indicators is complex; culture is an amorphous concept!]
- Act as a role model and ethics champion

# Practice Guide Evaluating Ethics-related Programs and activities [June 2012]

- This guide provides internal auditors with a framework for the evaluation of ethics-related programs and activities. Because various countries and cultures have different views of what is considered ethical behaviour, the guide provides a range of examples, definitions, and principles that are not meant to be comprehensive but provide a platform on which internal auditors can build their evaluations. The principles apply equally to the public and private sectors.



# Definition and Internal Audit Standard

## Definition

- A strong ethical culture is the foundation of good governance. An ethical culture is created through a robust ethics program that sets expectations for acceptable behaviours in conducting business within the organization and with external parties.



## IIA Standard 2110.A1

- Requires that internal audit evaluates the design, implementation and effectiveness of the organization's ethics-related objectives, programs, and activities.
- This Practice Guide provides guidance for evaluating program effectiveness and compliance; it includes a potential audit approach, procedures, tools, and techniques.

# Fulfilling the Role

- Internal Audit is responsible for assessing the governance process and recommending improvements to promote appropriate ethics and values within the organization.

## The internal audit activity may fulfill these responsibilities by:

- Assessing the state of the organization's ethical climate and the effectiveness.
- Evaluating the design, implementation, and effectiveness of the organization's ethics.
- Providing assurance that ethics programs achieve stated objectives.
- Providing consulting services.
- Serving as a role model and ethics advocate.
- Acting as a catalyst for change.
- Serving as a subject matter expert on ethics-related issues.



# PRACTICE GUIDE – KEY FEATURES

## •*Planning*

Review approved documents to gain an understanding of the organization's ethics programs.

## •*Assess Risks and Controls*

Using the information gathered in the planning phase.

## •*Undertake Testing*

There are a range of tools and techniques that may be used to test the organization's ethics program

## •*Design*

Will have been identified during the planning phase of the review

## •*Implementation*

The focus of this testing will likely be dependent on the maturity level of the organization's ethics-related objectives.

## •*Effectiveness.*

Internal auditors should assess the success of the ethics programs.

## •*Reporting.*

The Chief Audit Executive must consider the design of the report and decide to whom and how it will be disseminated.



# The Audit Process

## *Considerations for an audit of ethics*

- Given the range of components to ethics-related objectives, programs, and activities, the CAE will need to determine which components to include in the internal audit plan, based on assessment of applicable risk, the levels of assurance required, the level of maturity of the ethics related programs and the approach for conducting reviews.



# Examples of Audit Tools in Evaluating Organizational Ethics

## Maturity Model

➤ Ethics is a sensitive area that does not easily lend itself to traditional audit rating systems. Rather than give an audit opinion on ethics, it might be less inflammatory and more useful to assess the maturity of the various elements of the ethical climate using a maturity model. The following compliance and ethics program maturity model is an example.

ATTRIBUTE	IMMATURE	REPEATABLE	DEFINED	MATURE	WORLD CLASS
1. Code of Ethics ( <i>How effectively does the Code outline management's expectations regarding ethical conduct?</i> )	<ul style="list-style-type: none"> <li>• There is no formally documented code of ethics.</li> <li>• In general, there are no other means of communicating management's expectations regarding ethical conduct.</li> </ul>	<ul style="list-style-type: none"> <li>• A Code of Ethics has been developed, but it may not be comprehensive or current.</li> <li>• Experienced employees generally understand management's expectations regarding ethical conduct, but new employees may not have any way of determining those expectations.</li> </ul>	<ul style="list-style-type: none"> <li>• A comprehensive Code of Ethics exists, was approved by the Board and is reviewed every two to three years to determine what updates are needed.</li> <li>• All employees must sign off annually that they comply with the Code of Ethics.</li> <li>• New employees must sign a document asserting that they have read and understand the Code.</li> </ul>	<ul style="list-style-type: none"> <li>• Outside counsel reviews the Code of Ethics as appropriate to ensure it remains current and appropriate.</li> <li>• The Code of Ethics is reviewed annually and updated as necessary.</li> <li>• All employees must complete annual questionnaires that ask more probing questions regarding compliance with the Code of Ethics.</li> </ul>	<ul style="list-style-type: none"> <li>• Specific compliance policies are in place to support and provide additional guidance on key components of the Code of Ethics.</li> <li>• Periodic focus groups and/or surveys are conducted with a representative sample of employees to assess their understanding of the Code of Ethics and their perceptions on level of compliance throughout the organization.</li> </ul>

## *Entity wide Employee Survey*

- The ethical climate is not always what executives or the board want it to be or think it is. The ethical climate is what employees experience. Therefore, an entity wide survey should provide a reasonably accurate measure of the ethical climate. By identifying gaps between the desired and actual ethical climate, a survey can lead to action plans to bridge those gaps and thereby add great value to the organization.

### *Example*

The following is an example of a survey some internal auditors have used effectively. It is not focused exclusively on the ethical climate. Instead, the ethical issues are embedded into a broader survey.

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YOUR DEPARTMENT \_\_\_\_\_

In what state is your office located? ..... IL IN MI OH WI OTHER

**SAMPLE ENTITYWIDE EMPLOYEE SURVEY**

(PLEASE CIRCLE THE ONE RESPONSE THAT BEST DESCRIBES YOUR REACTION TO EACH STATEMENT.)

**KEY:** SA = Strongly Agree A = Agree D = Disagree SD = Strongly Disagree DK = Don't Know

**SECTION I: Company Culture**

*The company culture sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control. (PLEASE CIRCLE ONE FOR EACH.)*

- |   |    |   |   |    |    |
|---|----|---|---|----|----|
| 1. Senior management of my business unit demonstrates high ethical standards.                           | SA | A | D | SD | DK |
| 2. Senior management of my business unit strives to comply with laws/regulations affecting the company. | SA | A | D | SD | DK |
| 3. My supervisor complies with laws/regulations affecting the company.                                  | SA | A | D | SD | DK |
| 4. The performance targets in my work unit are realistic and obtainable.                                | SA | A | D | SD | DK |

- |  |    |   |   |    |    |
|--|----|---|---|----|----|
| 5. Employees in my work unit have the knowledge, skill, and training to perform their job adequately.                  | SA | A | D | SD | DK |
| 6. My business unit learns from its mistakes.  | SA | A | D | SD | DK |
| 7. Personnel turnover has not impacted my work unit's ability to effectively perform its function.                     | SA | A | D | SD | DK |
| 8. Integrity of financial and operational results always takes priority over reporting acceptable performance targets. | SA | A | D | SD | DK |
| 9. Employees in my work unit are treated fairly and justly.  | SA | A | D | SD | DK |
| 10. Employees in my work unit do not have to take unnecessary safety risks to perform their job.                       | SA | A | D | SD | DK |
| 11. If you disagree/strongly disagree with any of the above questions on Company Culture, why do you feel this way?    |    |   |   |    |    |

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**SECTION II: Goals and Obstacles**

*Organizations identify and analyze potential obstacles to the achievement of their goals to determine how to manage these obstacles. (PLEASE CIRCLE ONE FOR EACH.)*

- |  |    |   |   |    |    |
|--|----|---|---|----|----|
| 12. For the coming year, I am accountable for defined, measurable objectives.  | SA | A | D | SD | DK |
| 13. I have sufficient resources, tools, and time to accomplish my objectives.  | SA | A | D | SD | DK |
| 14. In my department, we identify barriers and obstacles and resolve issues that could impact achievement of objectives. | SA | A | D | SD | DK |

# Challenges for Internal Audit

- How do you gather evidence?
- Whilst an ethical culture can be tracked and measured in visible ways, the instruments for doing this, eg staff surveys, provide only indirect observations of behaviour at best. Employee surveys may be skewed if not underpinned by a culture of being able to speak openly and honestly!
- IA needs to upskill in qualitative methods such as surveys and interviews
- IA are used to reporting evidence based hard facts; gut feel will also be needed here! - IAs will need to use root cause analysis, ie going beyond processes and controls to look at behaviours that influence decisions
- IA is part of the ethical culture itself!
- IA needs to distance itself from cultural drivers, such as bonuses!

Thank you

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