

Auditing ethics: a suggested model

by José Rodrigues de Sousa Filho
Tribunal de Contas da União (SAI of Brazil)

1. INTEGRITY OBJECTIVES

COSO Internal Control Framework (COSO 2013) defines internal control as follows:

Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

Thus, the framework COSO 2013 has three separate categories of objectives but which may overlap:

Internal Control Objectives (Coso 2013)		
Operations Objectives	Reporting Objectives	Compliance Objectives
On the effectiveness and efficiency of the entity's operations, including safeguarding of assets.	On the reliability, timeliness and transparency of financial and non-financial reporting, internal and external.	On the adherence to laws, rules and external regulations applicable to the entity.

The compliance-related objectives refer to the obligations arising from laws, rules or regulations imposed on all activities of the entity, such as the tax, labor and regulations issued by regulatory agencies.

These standards establish minimum standards of conduct expected of the entity which does not prevent the organization to establish the objective of compliance with levels above the minimum standards.

The COSO 2103 considers that the objective of compliance with rules, policies and procedures relates to the operational objectives, while the objective of compliance refers properly only to the laws and external regulations.

It appears that this choice by external regulation in compliance concept is a matter of convenience COSO 2013. In fact, the logic of this framework accepts that a particular objective be regarded as in more than one category, or to jump from category to another, depending on the focus of the goal.

At this point, we understand perfectly feasible and compatible with the structure of COSO 2013 extend the concept of compliance to consider inserted into the set of rules to which the entity shall submit the code of conduct and ethical principles written and incorporated into the organization's regulations.

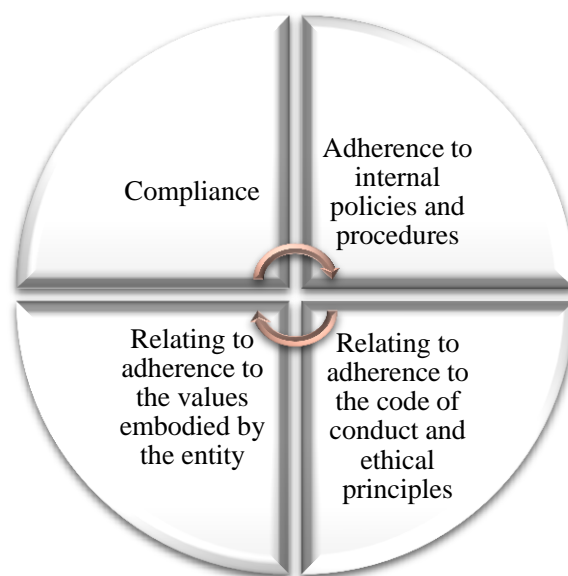
However, to avoid any misunderstandings with the concept of compliance widely known and defined in the COSO 2013, we can adapt the structure of COSO to

include among the main objectives pursued by the entity the objective of integrity, defined as compliance laws, rules and regulations, internal or external, which focus on the operational activities of the entity and the rules of conduct, ethical principles and values of the organization.

We then reformulate the objectives of internal control, from the adaptation of the structure of COSO 2013:

Objectives of Internal Control (adapted from Coso 2013)		
Operations Objectives	Reporting Objectives	Integrity Objectives
On the effectiveness and efficiency of the entity's operations, including safeguarding of assets.	On the reliability, timeliness and transparency of financial and non-financial reporting, internal and external.	On the adherence to laws, rules and regulations, external and internal, applicable to the entity, as well as the standards of conduct, ethics and values expressly assumed by the entity.

Note that the integrity objectives incorporate compliance objectives and add the dimension of ethics spelled out among the strategic objectives of the entity.



Integrity objectives

Knowing that the COSO 2013 is an integrated framework of objectives, five components, 17 principles of control and their points of focus, operating on an organizational structure, the proposed change in the entity's objectives reverberates over the other elements of the framework, so that the application of each principle is now also interpreted in the light of integrity objectives.

By introducing the commitment to the code of conduct and ethical principles in the entity's objectives we cause a resonance in all model parts, including the other

objectives, because the model requires an integration of all parties, that should work jointly to provide reasonable assurance of achieving the objectives set by the entity.

The use of the COSO framework as auditing tool is nothing new. According to INTOSAI GOV 9100 ("Guidelines for internal control standards for the public sector", 2004):

“Since evaluating internal control is a generally accepted field standard in government auditing, **auditors can use the guidelines as an audit tool.** The guidelines for internal control standards comprising the COSO model can therefore be used both by government management as an example of a solid internal control framework for their organisation, and by auditors **as a tool to assess internal control.**”

What could be considered a novelty in this paper is the adaptation of the COSO model to insert between the entity's objectives commitment to the code of conduct and ethical principles, which makes this adapted framework more consistent with a criterion against which the audit questions can be confronted.

2. A SUGGESTED MODEL TO AUDIT ETHICS

The ethics audit object

The definition of the audit object is the first step to prepare the audit planning and will shape the subsequent steps.

In matters related to ethics can be taken as audit object, for example:

- a) the adherence of "management practices and conduct" with the code of conduct and ethical principles embodied by the entity;
- b) the objective of the entity become a benchmark in ethical practices;
- c) the ethical management system deployed by the entity;
- d) the risk of unethical behavior in the preparation of financial statements;
- e) the risk of unethical behavior in procurements by a unit of the entity;
- f) internal communication of ethical misconduct by senior management and the other employees of the entity.

These examples of audit object above can be related to the three categories of objectives (operations, reporting, integrity objectives) of the adapted model of the COSO 2013, depending on the audit approach that wanted to adopt.

For example, the ethics management system deployed by the entity may prove to be examined from the point of view of efficiency and effectiveness of the system's operational processes, so that the audit object would be classified within the operations objectives of the entity.

On the other hand, we can examine the ethical management system focusing on the effectiveness of the code of conduct and ethical principles assumed by the entity so that the audit object would be framed in integrity goals.

Remember that the integrity of objectives encompass other issues beyond the proper ethical issues, including compliance with laws and external regulations, as we have seen.

The audit objective and scope

Chosen the audit object, the next step is to define the audit objective, which is usually done by means of a problem and audit questions which will be investigated and tested.

Audit issues enable us to define the the audit scope and drive the audit work, the choice of the most appropriate methodologies and techniques, as well as the expectations to be achieved.

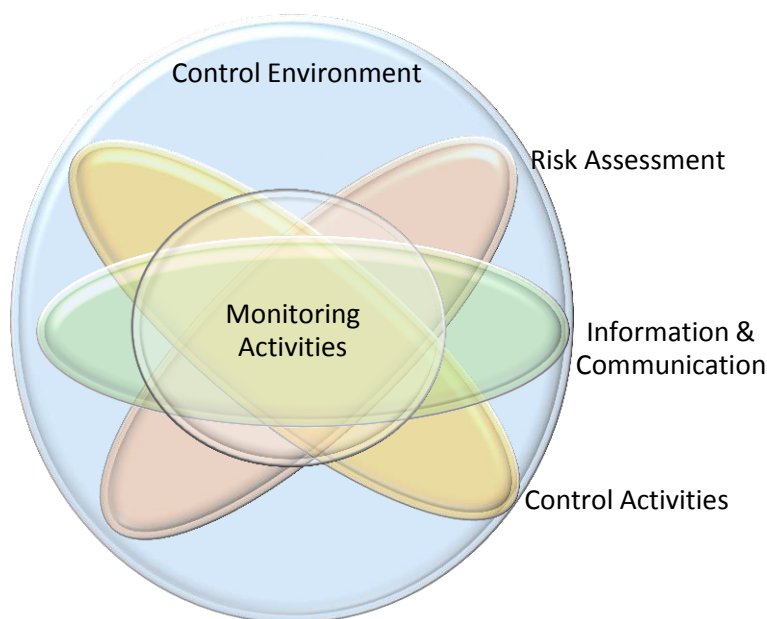
The audit criteria

The audit criterion is the standard against which the object will be collated and assessed. Without this mutual comparison between the situation observed and the situation envisaged in the model can not be said that there is an audit properly.

We propose in this study a model adapted from the 2013 COSO Framework (Internal Control - Integrated Framework), in which the integrity objectives include both complice objectives as those related to ethics, as we have explained in the first part of this study.

Alongside the objectives the COSO 2013 framework establishes five components and seventeen fundamental principles associated with the components. It's important to emphasize that all seventeen principles apply to each category of objective.

The five components are articulated to each other and work together in an integrated way. For the system to be considered effective, the model requires that each component and each principle are present, implemented and continually working together during operational activities to achieve the objectives set by the organization.



COSO Framework Components

From the audit object definition and the audit objective, we should elaborate the audit questions which, if answered, enable the auditor to express conclusive opinion on the audit objective.

Therefore, audit questions should be developed in conjunction with audit criteria against which the facts of reality will be opposed. Dysfunctional audit questions with the criterion weaken the possible conclusions of the audit and may even invalidate the entire audit report.

The following audit questions proposed to each principle should be adjusted to the specificities of the audit object with a view to achieving the the audit objectives. As appropriate, other issues should be developed to deepen the content a question or to explore other aspects involved in the evaluation of a particular principle.

Specific questions

Control Environment	Questions
P1. Demonstrates commitment to integrity and ethical values	<p>Q1. The administration demonstrates in its guidelines, actions and attitudes their commitment to ethical conduct and ethical principles?</p> <p>Q2. The organization published its code of conduct for all levels of the organizational structure and external suppliers?</p> <p>Q3. The entity evaluates the performance of employees and teams to meet the expectations of ethical conduct, identifies deviations and implements corrective actions in a consistent and timely manner?</p>
P2. Exercises oversight responsibility	<p>Q4. The administration oversees compliance with the code of conduct and functioning of the organization's ethical management system?</p> <p>Q5. The members of the administration are independent enough to make ethical decisions?</p>
P3. Establishes structure, authority and responsibility	<p>Q6. The administration has implemented and assesses the reporting lines between all levels of the organizational structure to enable the flow of information on ethical conduct practiced in the entity?</p>
P4. Demonstrates commitment to competence	<p>Q7. Policies and practices that define the competence needed to expectations of achievement objectives reinforce the need for observance of ethical conduct?</p>
P5. Enforces accountability	<p>Q8. Management establishes mechanisms for communicating and making employees accountable for performance of internal control on the ethics practiced throughout the organization?</p> <p>Q9. Management establishes performance measures, incentives and other rewards for appropriate responsibilities for the standards of conduct expected, at all levels of the organization?</p> <p>Q10. Management evaluates and adjusts the pressures</p>

	<p>associated with the necessary efforts to achieve the objectives?</p> <p>Q11. Management evaluates adherence to standards of conduct and provides rewards or apply disciplinary action, as appropriate?</p>
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Risk assessment

Questions

P6. Specifies suitable objectives	<p>Q12. The organization establishes a clear minimum standards of ethical conduct to be achieved for the integrity objectives?</p> <p>Q13. The entity establishes the acceptable levels of variation relative to the achievement of integrity objectives?</p>
P7. Identifies and analyzes risk	<p>Q14. The entity identifies, assesses and treats the risks, internal and external, that can achieve the integrity objectives?</p>
P8. Assesses fraud risk	<p>Q15. The entity assesses the risk of fraud, considering the various ways of fraud, opportunities for inappropriate actions by management and other people, the incentives and pressures for achievement of integrity objectives?</p>
P9. Identifies and analyzes significant change	<p>Q16. The entity identifies and evaluates the changes that internal and external factors may cause on the entity and affect the achievement of integrity objectives?</p>

Control activities

Questions

P10. Selects and develops control activities	<p>Q17. The entity has implemented a variety of appropriate controls to mitigate identified risks that may affect the achievement of integrity objectives?</p>
P11. Selects and develops general controls over technology	<p>Q18. The entity select and implement controls activities in its technology infrastructure used in achieving the integrity objectives?</p>
P12. Deploys through policies and procedures	<p>Q19. The entity establishes control activities that are deployed in operational processes through policies that establish the expected conduct, which may affect the achievement of "integrity objectives"?</p>

Information & Communication

Questions

P13. Uses relevant information	<p>Q20. The entity identifies and uses the information required and expected to support the other components of internal control and fulfill integrity objectives?</p>
P14. Communicates internally	<p>Q21. The entity uses communication processes to disseminate and clarify the code of conduct and ethical principles for all those involved with the achievement of objectives?</p> <p>Q22. The entity puts in place internal communication channels to receive anonymous reports and confidential</p>

	communications regarding conflicts of interest and breaches of code of conduct and ethical principles?
P15. Communicates externally	Q23. The entity establishes and puts in place open channels of communication with external parties (consumers, customers, suppliers, external auditors) to receive information relating to ethical violations or that may create a conflict of interest?

Monitoring Activities	Questions
P16. Conducts ongoing and/or separate evaluations	Q24. The entity periodically assesses the adequacy and effectiveness of controls that work to ensure the achievement of integrity objectives?
P17. Evaluates and communicates deficiencies	Q25. The entity reports deficiencies identified in controls to responsible parties to adopt corrective actions, and timely monitors the implementation of these actions?

Methodological approach:

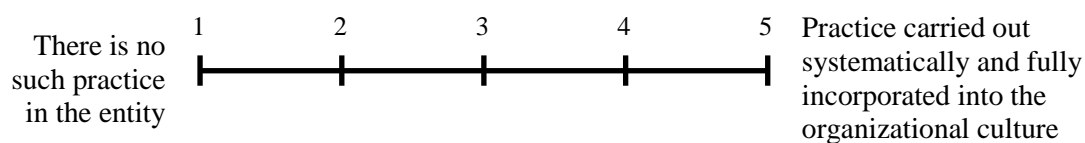
The challenge faced by an audit of ethics lies in the development and application of appropriate methods to make the comparison between the reality in which the entity operates and the "audit criteria" to obtain satisfactory and acceptable answers to the audit questions, considering that the analysis involves concepts and behavioral, subjective and cultural aspects difficult to assess.

The COSO Framework brings neither imposes methods of analysis and evaluation of components and principles, because the choice of method depends on the object and the audit objectives.

However it is important to distinguish two methodological approaches that have been applied to assess objectives related to ethical principles.

The first approach uses a search by means of a questionnaire which is filled by the entity. Questions can be grouped by layer or relevant function of the object. Each question of the questionnaire is given a score, which is aggregated for each layer or function evaluated. Weights can be adopted for each question and also by layer or function, resulting in the development of one or more indexes.

For example, we can adopt the following scale for each question or questions that are designed to evaluate the functionality of each of the 17 principles of the COSO 2013:



Carrying out the relevant aggregations, we calculate an indicator for each component of COSO and a general indicator for the "maturity" of the entity.

Among the models that apply this approach we can indicate the integrity of survey conducted by the State Audit Office of Hungary (SAO)¹, which is based on SAINT adapted framework model. The result of this survey gave rise to calculate three indicators called: Inherent Vulnerability Factors (EVT), Enhancing Factors Corruption Vulnerability (KVNT) and Factors of Risk-Reducing Controls (KMKT), expressed as a percentage.

It is highlighted that this approach alone is not a proper audit because an audit requires that the survey data are confronted with the audit criteria and tested the reliability of the information collected by the survey.

However, a survey is a great method to be used in the audit work, taking care to ensure the reliability and quality of information collected.

The other approach is based on the use of structured models to address particular audit question. It is not a mere survey, although the survey can be used as a convenient techniques for obtaining the data required by the model.

For example, to answer the question 14 ("The organization identifies, assesses and treats the risks, internal and external, that can affect the integrity of goals?"), The auditor may compare the risk management performed by the entity with the model risk management required by ISO 31000.

In another example, if the audit question is focused on the estimated risk of unethical behavior, you can adapt some of the techniques contained in ISO 31110 for identification and risk assessment or build or apply an existing model to calculate this risk².

¹ PULAY, Gyula. Preventing corruption by strengthening organisational integrity. *Public Finance Quarterly*. 2014/2.

² Cf. FERREIRA, Antonio Sergio Seco. Um modelo para avaliação de susceptibilidade de entidades públicas a desvios éticos. In: BRASIL. Presidência da República. Casa Civil. Comissão de Ética Pública. Desvios Éticos: risco institucional. Brasília: ESAF - 2002.