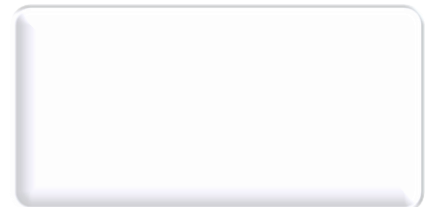
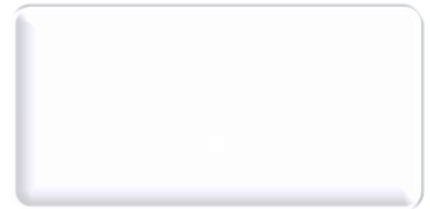
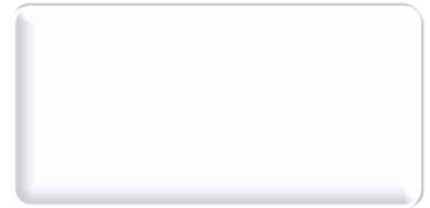




TRIBUNAL DE CONTAS DA UNIÃO

# Auditing ethics: a suggested model

**José Rodrigues de Sousa Filho**  
Secretaria de Métodos e Suporte ao Controle Externo - Semec



# Ethics Auditing: a suggested model



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## *Issues*

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- The audit object  
.....
- The audit objective and scope  
.....
- The audit criteria  
.....
- The audit questions  
.....
- The methodological approaches  
.....



## Conclusion

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# Ethics Auditing: audit object



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## ***Examples of audit objects:***

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- the adherence of management with the code of conduct and ethical principles embodied by the entity

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- the objective of the entity becoming a benchmark in ethical practices

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- the ethical management system deployed by the entity

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- the risk of unethical behavior in the preparation of its financial statements

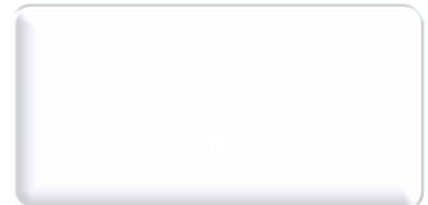
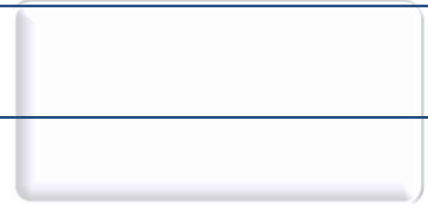
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- the risk of unethical behavior in procurements by a unit of the entity

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- internal communication of ethical misconduct by senior management and the other employees of the entity.

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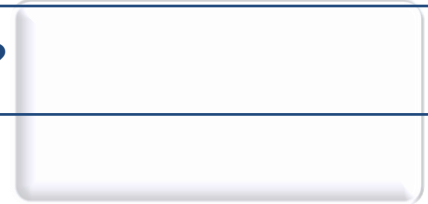
# Ethics Auditing: audit objectives and scope



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## ***What is the audit objective? What will not be audited?***

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- The audit objective is specified by means of a problem and related audit questions to be investigated.
- The audit question is the key to determine the direction of the audit engagements and to define the methods and techniques to be used.

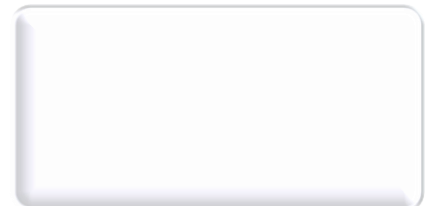


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### **Example of audit problem:**

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- The organization performs high-amount procurement, every year in an uncompetitive market. There have been proven cases of corruption related to the entity's contracts. So it is important to evaluate the entity's commitment to the ethical principles and adherence to the code of conduct.



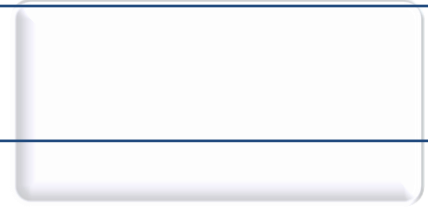
# Ethics Auditing: audit criteria



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## ***Specification of the audit criteria***

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- The audit findings result from the comparison between the criterion and the existing situation.

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- Criterion = what “should be”  
= the best practices  
= benchmarks  
= frameworks

---

- The definition of appropriate criteria should meet also the following characteristics (ISSAI 3000/Appendix 2, 2004):

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- Reliability, Objectivity, Utility, Clarity, Comparability, Completeness, Acceptability



# Ethics Auditing: audit criteria

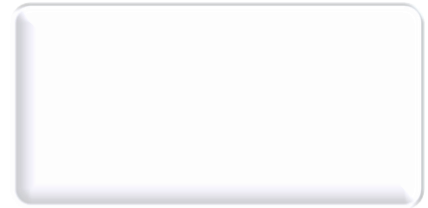
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## *Specification of the audit criteria*

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- So, the audit criterion must be consistent with the object and the objective of the audit.
- this means that if the audit object is the management of ethics by the entity, the criterion should be a management framework.
- Similarly, to audit the governance of ethics, we need a governance framework as a criterion.
- To audit the soundness of the control environment and the commitment to ethics, we need an internal control framework.
- to audit the risk of unethical behavior, we need a consistent model as a criterion in order to realize which variables and their relationships that can result in this kind of agent behavior.
- to audit the entity's risk management, we need a plausible risk management model as a criterion,
- and so on.

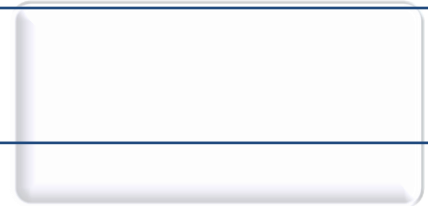
# Ethics Auditing: audit criteria



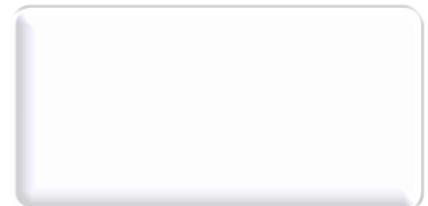
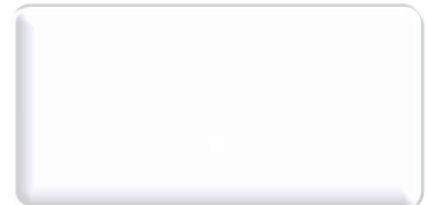
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## ***Specification of the audit criteria***

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- Internal Control COSO Framework as a criterion to audit the soundness of the control environment and the commitment to ethics.  
.....
- Why?  
.....
- Because the COSO framework already integrates ethics in its internal control structure as a fundamental, although we suggest a change in the entity's objectives in order to strengthen the role of ethics in the entity.  
.....



# Ethics Auditing: COSO criteria

## ***The Internal Control – Integrated Framework (COSO 2013) sets forth:***

3 categories of objectives

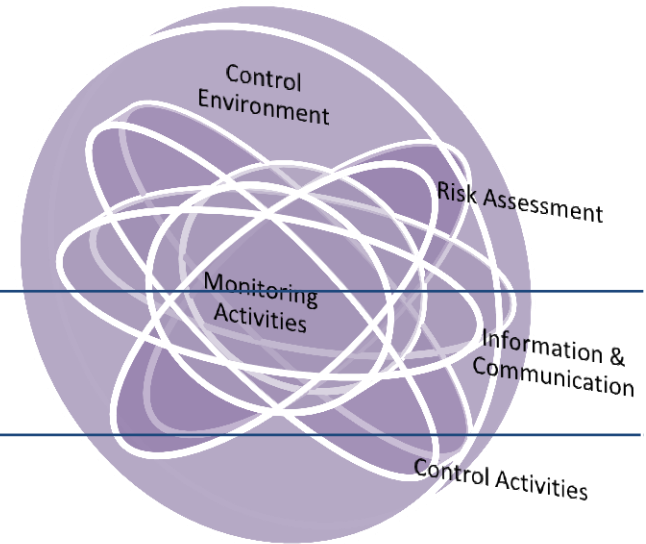
5 components of internal control

17 principles

81 points of focus

An objective in one category may overlap or support an objective in another.

Each component cuts across and applies to all three categories of objectives.





# Ethics Auditing: COSO criteria

## ***Principles relating to the Control Environment component***

### **1. The organization demonstrates a commitment to integrity and ethical values**

2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.

3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.

4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.

5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.



# Ethics Auditing: COSO Criteria

## ***P1. The organization demonstrates a commitment to integrity and ethical values***

Points of focus:

- Sets the Tone at the Top
- Establishes Standards of Conduct
- Evaluates Adherence to Standards of Conduct
- Addresses Deviations in a Timely Manner



# Ethics Auditing: COSO Criteria

## **Operations Objectives**

On the effectiveness and efficiency of the entity's operations, including safeguarding of assets.

Compliance with an entity's internal policies and procedures

## **Reporting Objectives**

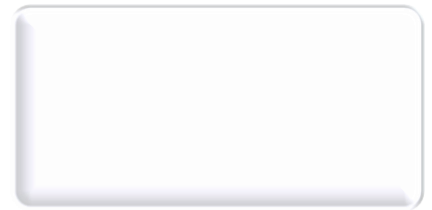
On the reliability, timeliness and transparency of financial and non-financial reporting, internal and external.

## **Compliance Objectives**

Compliance with external laws and regulations.



# Ethics Auditing: COSO criteria



## *Integrity Objectives*



Compliance (COSO 2013)

Compliance to internal policies and procedures

Adherence to the values embodied by the entity

**Adherence to the code of conduct and ethical principles**



# Ethics Auditing: OECD Ethics Infrastructure audit criteria

## ***Specification of the audit criteria***

- OECD Ethics Infrastructure
- OECD has identified the institutions, systems, tools, and conditions that governments use to promote integrity in the public sector – the necessary elements and functions of a sound ethics infrastructure.

<b>Functions</b>	<b>Elements</b>
Guidance	<ul style="list-style-type: none"><li>▪ Strong commitment from political leadership</li><li>▪ Workable codes of conduct expressing values and standards</li><li>▪ Professional activities such as education and training</li></ul>
Management	<ul style="list-style-type: none"><li>▪ Supportive public service conditions such as management policies and practices</li><li>▪ Ethics coordinating body</li></ul>
Control	<ul style="list-style-type: none"><li>▪ Effective legal framework enabling independent investigation and prosecution</li><li>▪ Efficient accountability and control mechanisms</li><li>▪ Transparency, public involvement and scrutiny (active civil society)</li></ul>

# Ethics Auditing: OECD Ethics Infrastructure audit criteria

## ***The OECD Principles for Managing Ethics in the Public Service***

### **12 Principles**

*It provides guidance to policy makers to review their integrity management systems (instruments, processes and actors).*

#### **Functions:**

- Determining and defining integrity
- Guiding towards integrity
- Monitoring integrity
- Enforcing integrity

- 1. Ethical standards for public service should be clear;*
- 2. Ethical standards should be reflected in the legal framework;*
- 3. Ethical guidance should be available to public servants;*
- 4. Public servants should know their rights and obligations when exposing wrongdoing;*
- 5. Political commitment to ethics should reinforce the ethical conduct of public servants;*
- 6. The decision-making process should be transparent and open to scrutiny;*

# Ethics Auditing: OECD Ethics Infrastructure audit criteria

## ***The OECD Principles for Managing Ethics in the Public Service***

### ***12 Principles***

*It provides guidance to policy makers to review their integrity management systems (instruments, processes and actors).*

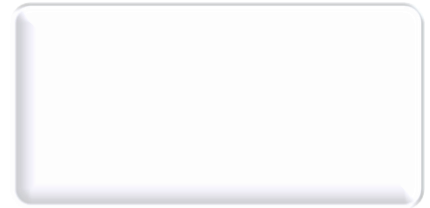
#### **Functions:**

- Determining and defining integrity
- Guiding towards integrity
- Monitoring integrity
- Enforcing integrity

- 7. There should be clear guidelines for interaction between the public and private sectors;*
- 8. Managers should demonstrate and promote ethical conduct;*
- 9. Management policies, procedures and practices should promote ethical conduct;*
- 10. Public service conditions and management of human resources should promote ethical conduct;*
- 11. Adequate accountability mechanisms should be in place within the public service;*
- 12. Appropriate procedures and sanctions should exist to deal with misconduct.*



# Ethics Auditing: a suggested model



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## *Issues*

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- The audit object  
.....
- The audit objective and scope  
.....
- The audit criteria  
.....
- **The audit questions**  
.....
- The methodological approaches  
.....



## Conclusion

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# Ethics Auditing: audit questions (COSO approach)

## ***Control Environment***

## ***Questions***

P1. The organization demonstrates a commitment to integrity and ethical values.

---

### Points of focus:

- Sets the Tone at the Top
  - Establishes Standards of Conduct
  - Evaluates Adherence to Standards of Conduct
  - Addresses Deviations in a Timely Manner
- 

Q1. The administration demonstrates in its guidelines, actions and attitudes their commitment to ethical conduct and ethical principles?

Q2. The organization published its code of conduct for all levels of the organizational structure and external suppliers?

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?

# Ethics Auditing: audit questions (COSO approach)

## ***Control Environment***

## ***Questions***

P2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control

Q4. The administration oversees compliance with the code of conduct and functioning of the organization's ethical management system?

Q5. The members of the administration are independent enough to make ethical decisions?

### Points of focus:

- Establishes Oversight Responsibilities
- Applies Relevant Expertise
- Operates Independently
- Provides Oversight for the System of Internal Control

# Ethics Auditing: audit questions (COSO approach)

## ***Control Environment***

P3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.

### Points of focus:

- Considers All Structures of the Entity
- Establishes Reporting Lines
- Defines, Assigns, and Limits Authorities and Responsibilities

## ***Questions***

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?

# Ethics Auditing: audit questions (COSO approach)

## ***Control Environment***

## ***Questions***

P4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.

Q7. Policies and practices that define the competence needed to expectations of achievement objectives reinforce the need for observance of ethical conduct?

---

### Points of focus:

- Establishes Policies and Practices
  - Evaluates Competence and Addresses Shortcomings
  - Attracts, Develops, and Retains Individuals
  - Plans and Prepares for Succession
-

# Ethics Auditing: audit questions (COSO approach)

## ***Control Environment***

P5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

### Points of focus:

- Enforces Accountability through Structures, Authorities, and Responsibilities;
- Establishes Performance Measures, Incentives, and Rewards.;
- Evaluates Performance Measures, Incentives, and Rewards for Ongoing Relevance;
- Considers Excessive Pressures;
- Evaluates Performance and Rewards or Disciplines Individuals.

## ***Questions***

Q8. Management establishes mechanisms for communicating and making employees accountable for performance of internal control on the ethics practiced throughout the organization?

Q.9 Management establishes performance measures, incentives and other rewards for appropriate responsibilities for the standards of conduct expected, at all levels of the organization?

Q.10 Management evaluates and adjusts the pressures associated with the necessary efforts to achieve the objectives?

Q11. Management evaluates adherence to standards of conduct and provides rewards or apply disciplinary action, as appropriate?

# Ethics Auditing: audit questions (COSO approach)

## ***Risk Assessment***

P6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.

Points of focus:

### ***Compliance Objectives:***

- Reflects External Laws and Regulations
- Considers Tolerances for Risk

## ***Questions***

Q12. The organization establishes a clear minimum standards of ethical conduct to be achieved for the integrity objectives?

Q.13. The entity establishes the acceptable levels of variation relative to the achievement of integrity objectives?

# Ethics Auditing: audit questions (COSO approach)

## ***Risk Assessment***

P7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.

### Points of focus:

- Includes Entity, Subsidiary, Division, Operating Unit, and Functional Levels
- Analyzes Internal and External Factors
- Involves Appropriate Levels of Management
- Estimates Significance of Risks Identified
- Determines How to Respond to Risks

## ***Questions***

Q14. The entity identifies, assesses and treats the risks, internal and external, that may affect the integrity objectives?

# Ethics Auditing: audit questions (COSO approach)

## ***Risk Assessment***

P8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.

.....

### Points of focus:

- Considers Various Types of Fraud;
  - Assesses Incentive and Pressures;
  - Assesses Opportunities;
  - Assesses Attitudes and Rationalizations.
- .....

## ***Questions***

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?



# Ethics Auditing: audit questions (COSO approach)

## ***Risk Assessment***

P9. The organization identifies and assesses changes that could significantly impact the system of internal control.

---

### Points of focus:

- Assesses Changes in the External Environment;
- Assesses Changes in the Business Model;
- Assesses Changes in Leadership.

## ***Questions***

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?

# Ethics Auditing: audit questions (COSO approach)

## ***Control Activities***

P10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

### Points of focus:

- Integrates with Risk Assessment
- Considers Entity-Specific Factors
- Determines Relevant Business Processes
- Evaluates a Mix of Control Activity Types

## ***Questions***

Q17. The entity has implemented a variety of appropriate controls to mitigate identified risks that may affect the achievement of integrity objectives?

# Ethics Auditing: audit questions (COSO approach)

## ***Control Activities***

P11. The organization selects and develops general control activities over technology to support the achievement of objectives.

## ***Questions***

Q18. The entity select and implement controls activities in its technology infrastructure used in achieving the integrity objectives?

---

### Points of focus:

- Determines Dependency between the Use of Technology in Business Processes and Technology General Controls;
- Establishes Relevant Technology Infrastructure Control Activities;
- Establishes Relevant Security Management Process Control Activities;
- Establishes Relevant Technology Acquisition, Development, and Maintenance Process Control Activities

# Ethics Auditing: audit questions (COSO approach)

## ***Control Activities***

P12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

### Points of focus:

- Establishes Policies and Procedures to Support Deployment of Management's Directives;
- Establishes Responsibility and Accountability for Executing Policies and Procedures;
- Performs in a Timely Manner;
- Takes Corrective Action;
- Performs Using Competent Personnel;
- Reassesses Policies and Procedures.

## ***Questions***

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"?

# Ethics Auditing: audit questions (COSO approach)

## ***Information and Communication***

## ***Questions***

P13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.

Q20. The entity identifies and uses the information required and expected to support the other components of internal control and fulfill integrity objectives?

---

### Points of focus:

- Identifies Information Requirements;
  - Captures Internal and External Sources of Data;
  - Processes Relevant Data into Information;
  - Maintains Quality throughout Processing;
  - Considers Costs and Benefits.
-

# Ethics Auditing: audit questions (COSO approach)

## ***Information and Communication***

## ***Questions***

P14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.

### Points of focus:

- Communicates Internal Control Information;
- Communicates with the Board of Directors;
- Provides Separate Communication Lines;
- Selects Relevant Method of Communication.

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?

Q22. The entity puts in place internal communication channels to receive anonymous reports and confidential communications regarding conflicts of interest and breaches of code of conduct and ethical principles?

# Ethics Auditing: audit questions (COSO approach)

## ***Information and Communication***

## ***Questions***

P15. The organization communicates with external parties regarding matters affecting the functioning of internal control.

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?

### Points of focus:

- Communicates to External Parties;
- Enables Inbound Communications;
- Communicates with the Board of Directors;
- Provides Separate Communication Lines;
- Selects Relevant Method of Communication.

# Ethics Auditing: audit questions (COSO approach)

## **Monitoring Activities**

P16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

### Points of focus:

- Considers a Mix of Ongoing and Separate Evaluations;
- Considers Rate of Change;
- Establishes Baseline Understanding;
- Uses Knowledgeable Personnel;
- Integrates with Business Processes;
- Adjusts Scope and Frequency;
- Objectively Evaluates.

## **Questions**

Q24. The entity periodically assesses the adequacy and effectiveness of controls that work to ensure the achievement of integrity objectives?



# Ethics Auditing: audit questions (COSO approach)

## *Monitoring Activities*

P17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

### Points of focus:

- Assesses Results;
- Communicates Deficiencies;
- Establishes Baseline Understanding;
- Monitors Corrective Actions.

## *Questions*

Q25. The entity reports deficiencies identified in controls to responsible parties to adopt corrective actions, and timely monitors the implementation of these actions?

# Ethics Auditing: audit questions (OECD approach)

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***Questionnaire developed by the Public Ethics Commission, an agency of the executive branch, Brazil, aiming to evaluate the performance of the ethics infrastructure in the respondent organizations.***

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Control

Guidance

Management

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1. Does your organization set out general and specific standards of conduct applicable for its employees?
  2. Is the responsibility for ensuring the effectiveness of standards of conduct formally assigned to the area integrating the organizational structure?
  3. Does your organization have an ethics committee?
  4. Does your organization has protection mechanism for those who report ethical misconduct, as well as for those employees who are tasked to investigate the complaints?
  5. Does your organization identify areas, activities and processes most likely to ethical misconduct?
  6. Does the work plan of ethics management area result from the organization's planning?
  7. Has senior management demonstrated by specific acts be committed to the dissemination and complied with the standards of conduct by public declaration of this commitment?
-

# Ethics Auditing : audit questions (OECD approach)

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***Questionnaire developed by the Public Ethics Commission, an agency of the executive branch, Brazil, aiming to evaluate the performance of the ethics infrastructure in the respondent organizations.***

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Control

Guidance

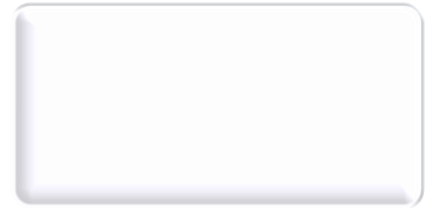
Management

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8. Are the standards of conduct disseminated among employees (public servants) of the organization?
  9. Are the standards of conduct part of the organization's training programs?
  10. Does the organization assess the knowledge of the standards of conduct by its employees?
  11. Are the standards of conduct disseminated to the general public, like service users and providers?
  12. Are there communication channels in place to receive questions and provide practical guidance on the application of the standards of conduct?
  13. Is compliance with the standards of conduct routinely monitored?
  14. Are misconduct and violation of standards of conduct investigated?
  15. Does your organization use some kind of recognition or reward to promote ethical conduct?
-



# Ethics Auditing: a suggested model



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## *Issues*

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- The audit object  
.....
- The audit objective and scope  
.....
- The audit criteria  
.....
- The audit questions  
.....
- **The methodological approaches**  
.....



## Conclusion

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# Ethics Auditing: methodological approaches

## *Survey approach*

- Questionnaire that is filled up by the entity;
  - Questions are grouped by layers or relevant functions of the object;
  - Each question is scored, then summed up to each layer or function evaluated;
  - Weights can be adopted for each question and also by layer or function.
  - Indexes are calculated.
- Example :**
- Integrity survey conducted by the State Audit Office of Hungary (SAO);
  - Based on INTOSaint adapted framework model;
  - Inherent Vulnerability Factors (EVT);
  - Enhancing Factors Corruption Vulnerability (KVNT);
  - Factors of Risk-Reducing Controls (KMKT).

# Ethics Auditing: methodological approaches

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## ***Structured models approach***

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- Use of structured models to address particular audit question;
- Survey can be used as a convenient technique for obtaining the data required by the model.

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### **Example 1:**

In order to answer the question 14:

- The organization identifies, assesses and treats the risks, internal and external, that can affect the integrity objectives?

the auditor may compare the risk management performed by the entity with the model risk management required by ISO 31000.

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### **Example 2:**

If the audit question is focused on the estimated risk of unethical behavior, we can adapt some of the techniques contained in the ISO 31110 standard in order to identify and assess such risk.

We can also consider mathematical models to estimate the risk of unethical behavior, where certain variables such as the purchasing power and the regulatory power of the entity are used to calculate this kind of risk.

# Ethics Auditing: a suggested model

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## ***Conclusions***

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1. Ethics must be handled as a management and governance tool and not just as a matter of personal morality.
  2. We need a criterion which should be consistent with the object and the objective of the audit.
  3. COSO Framework can be taken as a suitable criteria to audit the control environment and the organization's commitment to ethics.
  4. The audit question is the key to determine the direction of the audit engagements and to define the methods and techniques to be used.
  5. A survey is a tool that can be used in an audit, but it does not replace the audit itself.
  6. We need to understand the limitations and scope of survey methodology that is applied to manipulate data obtained from the questionnaire.
  7. The use of appropriate and consistent methodology results in assurance of audit engagements and enhances acceptance of audit findings and recommendations.
-



Thank you!