Ethics and Auditing
Acknowledgements

The editors gratefully acknowledge the support of the Academy of The Social Sciences in Australia (ASSA), the Centre for Applied Philosophy and Public Ethics (CAPPE) and the Australian National Centre for Audit Assurance and Research (ANCAAR).
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Foreword: Restoring public trust

Bill Edge, PricewaterhouseCoopers
Australian Auditing and Assurance Standards Board (2002-04) Chairman

Enron, Parmalat, WorldCom, HIH – these corporate failures and accounting scandals have shaken the foundations of investor confidence in the transparency, integrity and accountability of corporations and capital markets. There has also been public disquiet about the role professional auditors and audit firms have played in these corporate scandals.

The consequences for many of the players in the market for financial information have been enormous; reputations both of key individuals and organisations are in ruins, jobs have been lost, and pension funds have been wiped out. The damage, both economic and social, has been incalculable, and the implications are far-reaching for corporate management, company directors, audit firms and the investing public.

An array of factors contributed to these events, but one thing is for certain – the billions of dollars in corporate value lost was due in significant part to unscrupulous management and boards of directors that failed to meet their responsibilities. The accounting profession, including auditors, also played a major role in these events. While the story behind these corporate failures is always complex, a lack of ethical behaviour by many individuals is a big part of it.

For the audit profession, these developments have again highlighted the gap between public expectations and the reality of the role of the auditor. With Enron in particular, the public perception was that the auditor should have acted as a control on unscrupulous management practices. The conclusion reached by many members of the public (and parliamentarians) was that the auditors failed in this responsibility because their independence from the management of Enron was compromised. While it is by no means as simple as that, the audit profession must acknowledge and address these types of perceptions, or indeed facts, if it is to restore trust in both the capital markets and itself.

The biggest challenge ahead for auditors is to identify how ethical behaviour can be – and be seen to be – restored, as it is this that will be the basis for the reconstruction of public trust in the profession and in the practice of auditing. This book does not purport to provide all the answers, but it highlights the importance of ethics and provides some thought-provoking commentary on the means in which ethical behaviour can be embedded in our personal and professional culture – one of the essential components to restoring public trust.
The response: regulation, regulation, regulation ... 

The response of governments worldwide to corporate scandals has been greater regulation. This response is often taken in the name of supporting the need for protecting the public’s interest. Attention has been focused on flaws in the capital market and reforms to corporate reporting and accounting/auditing that may rectify them.

Stock exchanges, global and local accounting and auditing standard-setters, institutional investors and other stakeholders have called for transparency and accountability in corporate governance, business ethics and corporate reporting. New laws and best practice guidance require strict monitoring of auditor independence, codes of ethical conduct, more disclosures, and CEO/CFO certification of various key statements in corporate reports. The aim of these requirements is to ensure effective checks and balances are in place so that good corporate governance and business ethics are observed.

Regaining trust

Why regulation isn’t the only answer

Regulation alone will not regain public trust. Confidence in the capital markets depends on confidence that the reporting and regulatory process will deliver accountability and transparency. This in turn depends on integrity – and integrity depends on one’s core ethical beliefs and behaviours.

A state of mind: ethical behaviour

Ethical behaviour is not simply conforming to legal and professional rules; it is a state of mind, the following of unwritten principles, a culture of ‘doing the right thing’.

An individual’s interpretation of ethical behaviour is influenced by a variety of factors including industry and company guidelines, social and economic pressures, laws and regulations, and the surrounding values and beliefs. These influences develop a set of written and unwritten principles which are drawn on when faced with an ethical dilemma.

Auditors face ethical questions on a daily basis, and in a way that is unique to our profession. Arguably the underlying principle of the auditing profession’s ethics is independence. Auditors must balance their duty to their clients, their profession, society and numerous other stakeholders. An actual or perceived conflict of interest may arise as a result of these competing interests and lead to public distrust – a familiar sight in recent years. Confidence is quickly lost and slowly regained in these instances.
By the time people enter their professional careers, their personal ethics have been largely shaped. However, these ethics can be reinforced or, conversely, strained or even shattered by the corporate culture in which they work. It is essential that audit firms – and, for that matter, all organisations – entrench a culture that fosters ethical behaviour.

**The framework for rebuilding public trust: an ethical code of conduct**

It is inevitable that an auditor will be faced with ethical decisions during the course of their career. It is therefore fundamental that appropriate and professional decision-making protocols and behaviours are ingrained in the culture in which they work.

A strong code of professional and personal ethical guidelines is a critical starting point to embedding ethical behaviour. The accounting bodies in Australia each have a code of conduct to provide authoritative guidance on professional conduct. The codes set out general guidelines on concepts such as independence, competence and honesty, as well as statements addressing specific issues of professional behaviour. These guidelines are backed with the power to monitor and penalise non-conforming members.

Similarly, staff and partners of the Big Four auditing firms operate within global codes of conduct, which articulate the principles of integrity and accountability by which generations of audit professionals have been guided.

Written codes of conduct that are comprehensive and clear are now seen as an essential element of good governance and ethics for all organisations.

Codes of conduct are pro-active statements about an organisation’s position on ethical and compliance matters. They are not usually legally binding and they are not a complete or exhaustive list. The essential elements of a code should include:

- an emphasis on communication and training around core values
- building a culture that motivates responsible business conduct
- encouraging employees to ask questions about ethics and report potential violations, without fear of reprisal
- values that are clear and meaningfully reinforced
- the establishment of confidential reporting frameworks to encourage communication and protect whistleblowers
- incident management processes that support due process and consistent enforcement
- processes in place to monitor the program as well as emerging standards and risks to ensure ongoing improvement.
Leading ethical and compliance programs enable forward-thinking, continuous improvements and effective change management. Common attributes of successful programs include:

- ‘tone at the top’ board management styles
- a values-driven code of conduct
- whistleblower protection
- integration of business processes.

‘Tone at the top’ board management styles

‘Tone at the top’ is characterised by the board and senior management (or, in an audit firm, its leadership team and the partnership) having a strong, unified vision of ethics and the purpose of the ethics program. Management are delegated responsibility for the planning and implementation of effective ethics and compliance policies, with board-leadership team oversight ensuring the implementation occurs and ongoing corporate responsibilities are met.

The board-leadership team must live by the code of conduct, just as they expect all others in the organisation to live by it. People in an organisation pick up quickly on how the ‘the top’ deal with outliers of the ethical code. The board-leadership team must infuse an organisational culture of ethics, and effective communication is essential to achieve this culture.

A values-driven code of conduct

The code of conduct must be clearly written and outline both management and key stakeholders’ values. The code must be meaningfully communicated to employees and associated parties. A sample of topics covered by the accounting bodies’ codes of conduct includes:

- fundamental principles
  - public interest
  - integrity
  - objectivity
  - independence and conflicts of interest
  - confidentiality
  - competence and due care
- other matters
  - resolution of ethical conflicts
  - advertising, publicity and solicitation
  - changes in professional appointments
  - incompatible business
  - opinion requests.
A further sample of the key topics that individual organisations, including auditing firms, might cover in their codes of conduct are listed in Table 1:

Table 1. Sample topics to be covered in a code of conduct

<table>
<thead>
<tr>
<th>Affirmative action/equal opportunity/non-discrimination</th>
<th>Financial reporting/record-keeping</th>
<th>Product safety and suitability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Antitrust/fair trading/competition</td>
<td>Gifts and entertainment</td>
<td>Professional development</td>
</tr>
<tr>
<td>Bribery and kickbacks</td>
<td>Insider information and trading</td>
<td>Protection of proprietary and confidential information</td>
</tr>
<tr>
<td>Community service and philanthropy</td>
<td>Intellectual property/copyrights</td>
<td>Responsible supply chain</td>
</tr>
<tr>
<td>Compensation and benefits</td>
<td>Joint ventures and strategic alliances</td>
<td>Sexual and other harassment</td>
</tr>
<tr>
<td>Conflicts of interest</td>
<td>Media relations and public image</td>
<td>Substance abuse</td>
</tr>
<tr>
<td>Corporate giving</td>
<td>Money-laundering and fraud</td>
<td>Travel and expense reporting</td>
</tr>
<tr>
<td>Corporate governance and structure</td>
<td>Personal use of company assets</td>
<td>Union relations</td>
</tr>
<tr>
<td>Criminal convictions and civil actions</td>
<td>Political activities/lobbying/contributions</td>
<td>Use of communications tools</td>
</tr>
<tr>
<td>Employee health, safety and welfare</td>
<td>Privacy</td>
<td>Wage laws and fair labour practices</td>
</tr>
<tr>
<td>Environmental compliance</td>
<td>Private investments and outside business activities</td>
<td>Work/life balance</td>
</tr>
</tbody>
</table>

The code of conduct can be contained in a variety of materials, to ensure it is embedded into the organisational culture. Some suggested elements of a comprehensive code of conduct framework are listed in Table 2.

Table 2. Elements of a code of conduct framework

<table>
<thead>
<tr>
<th>Introductory materials</th>
<th>Ethical conduct policies</th>
<th>Compliance administration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisational mission statement</td>
<td>Statement of relevant values and the policy’s positive intent</td>
<td>Ethics and compliance certification form</td>
</tr>
<tr>
<td>Letter from the CEO</td>
<td>Clear and succinct statement of the policy</td>
<td>Directory of key contact persons</td>
</tr>
<tr>
<td>Statement of values/organisational principles</td>
<td>Brief examples of acceptable and unacceptable conduct</td>
<td>Links/references to related information</td>
</tr>
<tr>
<td>General statement of compliance with laws and regulations</td>
<td>Consequences of misconduct to the organisation and employees</td>
<td>Compliance and ethics reporting procedures (e.g., hotline / whistleblower protection)</td>
</tr>
<tr>
<td></td>
<td>Reference to specific policies</td>
<td>Due process regarding ethics and compliance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Decision-making assistance</td>
</tr>
</tbody>
</table>

Whistleblower protection

Whistleblower protection is one of the hot topics of corporate ethics. While it is a vital element of any corporate governance strategy, a whistleblower protection policy will not of itself work to ensure corporate ethics are observed. Employees will not utilise help lines or report misconduct if they are not satisfied that their actions will be supported, as the ramifications can be significant to an individual’s personal and professional life.
For auditors, the focus must be on supporting audit teams in any dispute with a client. Audit partners must know that they will be protected – even rewarded – if they take a firm stance against an accounting practice they feel is potentially misleading.

**Integration of business processes**

Finally, integration of business processes ensures that the ethics and compliance program becomes operational and effective. This includes:

- Developing clear policies and procedures
- Communicating to, and training, employees about the code of conduct and related practices
- Monitoring progress
- Reporting to management/partners and the board-leadership team
- Fine-tuning strategies
- Communicating the company’s successful performance to key stakeholders.

Measuring the effectiveness of ethics programs is difficult, but it is essential to ensuring ethical behaviour is integrated into the organisational processes. There are a number of ways to monitor and assess the successful embedding of ethical behaviours. Some of the more common performance indicators include:

- Code of conduct awareness signatures
- Helpline awareness, call resolution and trends
- Adequacy of program documentation
- Risk management and early detection
- Consistency of enforcement
- Ethical culture surveys and employee opinions
- Management’s response to issues raised.

**Conclusion**

Corporate governance, business ethics and effective compliance management are increasingly critical to an organisation’s reputation and success. To regain public trust, safeguard reputation and grow market share, all organisations need to embed ethics and compliance into their culture and core business processes. They also need a mechanism so that they can be seen by the public at large to have these processes working effectively.

A framework and process for corporate governance, business ethics and compliance management that weaves together a ‘top-down’ approach to managing accountability with ‘bottom-up’ compliance processes is a large step in the right direction.
The ultimate success or failure of an organisation’s code of conduct and business ethics program will rest upon the values and culture created by the board of directors or leadership team, and ultimately embraced by all its people.
Ethics and Auditing

References
