Ethical Considerations for Internal Auditors

IIA Birmingham

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Discussion topics

- Ethics and Organizations
- International Professional Practices (IPPF) Framework
  - Code of Ethics
- Ethical Considerations and Criteria
- Scenarios to Consider
- Wrap Up and Conclusions
Polling Question 1

Please indicate your current role:

a. Internal Audit - Chief Audit Executive or Director
b. Internal Audit - Management
c. Internal Audit - Senior or Staff
d. Risk Management or Compliance Professional
e. Other
Definitions

**Ethics**
- Principles that govern a person’s behavior or the conduct of an activity
- What is good and bad considering moral duty and obligation
- Rules of behavior based on ideas about what is good and bad

**Values**
- The beliefs of a person, social groups or organizations; they are rules by which one makes decisions about right and wrong, should and should not, good and bad.

Dictionary.com
Definitions

Ethical Behavior

“Acting in ways consistent with what society and individuals typically think are good values. Ethical behavior tends to be good for business and involves demonstrating respect for key moral principles that include honesty, fairness, equality, dignity, diversity, and individual right.”

Ethical Issue

“A problem or situation that requires a person or organization to choose between alternatives that must be evaluated as right (ethical) or wrong (unethical).”

businessdictionary.com
## Factors affecting ethical behavior

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<th>Positive Influence</th>
<th>Risks/Negative Behavior</th>
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<td>Desire for professional recognition</td>
<td>Financial pressure</td>
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<td>Commitment to ethical behavior</td>
<td>Emulate actions viewed as ‘successful’; rationalize</td>
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<td>Encourages ownership of results</td>
<td>Values short-term results</td>
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<td>Publicly reinforces ‘do the right thing’</td>
<td>Performance metrics reward poor ethical behavior</td>
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<td>Reinforces ‘tone at the top’ and ethical commitment</td>
<td>Unwritten and dangerous risk appetite</td>
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**Ethics and Pressure: Balancing the Internal Audit Profession, Exhibit 13, Rittenberg, CBOK, IIA Foundation, 2016**
Polling Question 2

Have you faced (a) significant ethical challenge(s) in your career?

a. Yes, periodically
b. Yes, rarely
c. Yes, only 1 time
d. No
e. Unknown
International Professional Practices Framework
IIA Code of Ethics principles

... integrity of internal auditors establishes trust and provides the basis for reliance on our judgment.

... in gathering, evaluating, and communicating information about activity/process being examined ... making balanced assessment ... not unduly influenced by own interests or by others in forming judgments.

... respect value and ownership of information received ... do not disclose information without appropriate authority, unless there is legal or professional obligation.

... apply the knowledge, skills, and experience needed in the performance of internal audit services.
## Associated rules of conduct

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<th>Principle 1 - Integrity</th>
<th>Principle 2 - Objectivity</th>
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<tr>
<td>Perform with honesty, diligence, responsibility.</td>
<td>Shall not participate in activity or relationship that may impair or be presumed to impair unbiased assessment. … includes activities or relationships in conflict with interests of organization.</td>
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<td>Observe law and make disclosures expected by law and profession.</td>
<td>Shall not accept anything that may impair or be presumed to impair professional judgment.</td>
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<td>Not knowingly be party to illegal activity or acts discreditable to profession or organization.</td>
<td>Disclose all material facts known that, if not disclosed, may distort reporting.</td>
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<td>Respect and contribute to legitimate and ethical objectives.</td>
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<th>Principle 3 - Confidentiality</th>
<th>Principle 4 - Competency</th>
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<td>Prudent in use and protection of information acquired in course of duties.</td>
<td>Engage only in services for which they have necessary knowledge, skills, and experience.</td>
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<tr>
<td>Shall not use information for personal gain or in any manner detrimental to legitimate and ethical objectives of the organization.</td>
<td>Perform services in accordance with IPPF.</td>
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<tr>
<td></td>
<td>Continually improve proficiency, effectiveness and quality of services.</td>
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Polling Question 3

Does your internal audit organization periodically share and/or discuss the IIA COE with the audit team?

a. Yes, at least annually
b. Yes, periodically, but not annually
c. Yes, when hired into the department
d. No
e. Unknown
Ethical Considerations and Criteria
Decision criteria

- Does legal = ethical?
- Does illegal = unethical?

How do you decide if something is ethical?
Decision criteria

- IIA Code of Ethics Review
  - Integrity
  - Objectivity
  - Confidentiality
  - Competency

- Simple Questions
  - Is it true?
  - Is it fair to all?
  - Is it free from harm?
  - Am I proud to do it?
Scenarios

Using the decision criteria to determine the correct ethical decision
Scenario 1

- An IT Auditor has been assigned to a systems development selection team to help evaluate available software packages. The auditor will provide input on software security and control features for the selection team.
- Two years ago, the auditor worked at an organization that created one of the programs being considered.
Polling Question 4

Select the answer you think is most appropriate:

a. The auditor has a clear conflict of interest and should not have been assigned
b. It is okay to assign the auditor if the conflict is disclosed
c. There is no conflict of interest as the role is restricted to providing advice
d. There is no conflict of interest as it was over a year since the auditor worked at the organization
e. Unsure
f. None of the above
Scenario 2

An auditor accepts tickets to a major league baseball game from a co-sourcing partner. A few weeks later, the auditor is part of a team evaluating several co-sourcing providers to hire a co-sourcing partner for the next year. The bidders include the provider who provided the tickets. Company policy prohibits significant gifts.
Polling Question 5

Select the answer you think is most appropriate:

a. The auditor acted unethically to accept the ticket and should not be assigned to the evaluation team.

b. It is okay to assign the auditor if the value of the ticket was below the Company threshold.

c. There is no conflict of interest as this is a customary practice and many have participated.

d. Unsure.

e. None of the above.
Scenario 3

- A city auditor reports to the Mayor and City Council. The auditor identifies significant cost overruns for a major application upgrade, which is being funded by a combination of local and state funds. Audit reports are posted on the City’s public website and discussed at City Council meetings, which are open to the public.

- Given the sensitive nature of this finding, the Mayor asks the auditor to “tone it down” and avoid quantifying the amount of the overrun. His rationale is that the upgrade is only 40% complete, he has spoken to the IT project manager and been assured that they will pull the spending back in line with approved funding. He believes the public will overreact to the finding.

- The auditor wonders if the upcoming election is also influencing the Mayor’s request.
Polling Question 6

Select the answer you think is most appropriate:

a. The CAE should not report now, but extend the audit and collect more information.

b. The CAE should report the finding, but “toned down” to exclude the overrun amount.

c. The CAE should issue the report with the amount of the overrun, but note management’s assertion that the final cost will be within budget.

d. Unsure

e. None of the above
Scenario 4

- A new internal audit manager is struggling to keep the audit team on schedule and on budget. Part of the issue is significant pushback from the client about the audit scope and materials requested.

- The manager holds a meeting the client and decides to reduce the scope, reducing the friction with management and enabling an on-time finish.
Polling Question 7

Select the answer you think is most appropriate:

a. The audit manager lacked integrity in reducing the scope to accommodate the client.

b. The audit manager collaborated with management to determine a more focused scope, there is no ethical issue.

c. The audit manager acted unethically as he does not have the authority to change the scope.

d. Unsure.

e. None of the above.
Scenario 5

- An audit manager assists in a fraud investigation that results in an executive being terminated. The organization chose not to prosecute the executive, who reimbursed the organization.

- A few weeks later, the audit manager learns from a friend, who is an internal auditor at another company, that the executive has been hired. The audit manager is debating whether he should tell his peer about the executive’s recent fraud.
Polling Question 8

Select the answer you think is most appropriate:

a. The audit manager has an ethical responsibility to let his peer know of the fraud.

b. The audit manager has an ethical responsibility to protect the confidentiality of his organization and therefore, not tell his peer.

c. The audit manager should discuss the situation with General Counsel for guidance.

d. Unsure.

e. None of the above.
Wrap Up
Wrap up and conclusions

- You will face ethical dilemmas!
- How you handle may be a ‘defining moment’
- Understanding how to make ethical decisions is important for each of us personally AND for our team members
  - Use COE principles and your personal value considerations to make the right decision
Key lessons from leaders

- “You need to be the change you want to see.”

- “Trust your gut to do the right thing for the customers. When there is a difficult decision to make, make it based on what would create long-term value instead of gaining the short-term win.”

- “Sometimes the things we think could really hurt us or embarrass us end up being the things that become our shining, most glorious moments.”
Additional resources

- Ethics and Pressure – Balancing the Internal Audit Profession, CBOK 2015, Dr. Larry Rittenberg
- IIA Implementation Guides (various)
- Evaluating Ethics-related Programs and Activities, Supplemental Guidance, June 2012
- Independence and Objectivity, Supplemental Guidance, October 2011
- What You Can Do to Improve Ethics at Your Company, Harvard Business Review, December 2016, Christopher McLaverty and Annie McKee