Auditing for an Ethical Culture that is Resistant to Fraud and Misconduct

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About Jay Wagner

- Institute of Internal Auditors (IIA):
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- Chief Audit Executive, Office of the Illinois Attorney General
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Discuss key definitions pertaining to ethics, fraud, and culture.

Understand the significance of establishing *and maintaining* a ethical culture.

Discuss the difference between behaving legally and ethically.

Discover the other fraud triangle, and explore the relationship between internal control and ethical culture.

Understand the red flags and some myths surrounding fraud and misconduct.

Learn the importance of resisting pressure.
What is Culture?

From The IIA’s Practice Guide: Auditing Culture:

“Culture is difficult to define; however, for the purposes of this supplemental guidance, organizational culture and the conduct that occurs within that culture is defined as follows:

Culture represents the invisible belief systems, values, norms, and preferences of the individuals that form an organization. Conduct represents the tangible manifestation of culture through the actions, behaviors, and decisions of these individuals.

This definition captures the complexity of defining and then assessing an intangible organization-wide quality or aspect that comprises human belief systems, social norms, and other psychological factors.

What is Internal Audit’s Role in Culture?

The word “culture” does not appear in any of the attribute or performance standards in the IIA’s Standards. It appears twice in the Standards document.

The word cultural appears in the first sentence of the Standards in the Introduction, although in this context it is not referring to an ethical perspective:

**Introduction to the Standards**
Internal auditing is conducted in diverse legal and cultural environments; for organizations that vary in purpose, size, complexity, and structure; and by persons within or outside the organization.

The other appearance is in the glossary definition of the Code of Ethics:

**Code of Ethics**
The Code of Ethics of The Institute of Internal Auditors (IIA) are Principles relevant to the profession and practice of internal auditing, and Rules of Conduct that describe behavior expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an **ethical culture** in the global profession of internal auditing.  

[Emphasis Mine]
Other Key Definitions

Ethics - Ethics is concerned with what is right and wrong. In A Critical Introduction to Ethics, Philip Wheelwright defined ethics as: “[The] branch of philosophy which is the systematic study of reflective choice, of the standards of right and wrong by which it is to be guided, and of the goods toward which it may ultimately be directed.” This definition contains three key elements:

• Ethics involves questions requiring reflective choice (decision problems).
• Ethics involves guides of right and wrong (moral principles).
• Ethics is concerned with values (goods) inherent in ethical decisions.

(Fraud Examiners Manual, page 4.901)

Fraud - Any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage. (IIA Standards Glossary)

Internal Control - often referred to as management controls, in the broadest sense includes the plan of organization, methods, and procedures adopted by management to meet its missions, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting, and monitoring program performance. Internal control also serves as the first line of defense in fraud, and violations of laws, regulations and provisions of contracts and grant agreements. (U.S. Government Auditing Standards)
What do the *Standards* have to say about culture?

Though culture is not addressed directly, it is closely tied to ethics, which is frequently mentioned:

- The Code of Ethics must be defined in the Internal Audit Charter (AS 1000)
- The Charter must recognize the mandatory nature of the Code of Ethics (AS 1010)
- A conflict of interests exists even when no unethical acts occur (AS 1120)
- The Quality Assurance and Improvement Program (AS 1300,) requires an evaluation of adherence to the Code of Ethics during internal assessments (AS 1311) and external assessments (AS 1312)
- Noncompliance with the Code of Ethics must be reported to senior management and the Board (AS 1320, AS 1322, AS 2060, and AS 2431)
- An internal audit activity is only considered effectively managed if all auditors adhere to the Code of Ethics (AS 2000)
- Internal Audit must assess governance and make appropriate recommendations that promote appropriate ethics and values within the organization (AS 2110 and AS 2110.A1)
- In addition to the glossary definition of *Code of Ethics* (previous slide), the glossary includes **ethical values** as an element of the control environment (definition of *Control Environment*)
One reason we start by discussing ethics in internal audit can be summed up in one word: credibility.

It is understandably frustrating to receive ethical advise from a party perceived as unethical. This is true for recommendations made by auditors. As the old saying goes, “first heal thyself.”

The intangible value of being regarded as ethical cannot be overstated.

This is true of internal audit, employees, as well as senior management, the Board, and organization as a whole.

We should be more than just internal auditors, we should aspire to be Trusted Advisors (IIA President and CEO Richard Chambers wrote an entire book with this title).
According to the IIA’s *Practice Guide on Auditing Culture*, there are identifiable key risk factors:

- Unreasonable expectations including deadlines, profitability, or levels of efficiency.
- Incentives not aligned with values.
- Employees (including internal auditors) lack knowledge of key risk management activities and potential risk impacts.
- An inflexible hierarchy impeding the flow of information up, down, and across the organization.
- A pervasive environment of mistrust toward auditors and regulators including a lack of understanding of the role of controls in achieving business objectives.
- An attitude of hubris (e.g., “That will not happen here.” or “That has never happened to us before.”)
- Lack of accountability, especially at senior levels of the organization.
- Failure to enforce codes of conduct and related policies and procedures.
- Management (and, in some cases, the Board) refusing to acknowledge information contrary to their opinions.
Red Flags and Risks to the Culture’s Ethics

The IIA’s *Practice Guide on Auditing Culture*, offers examples that are too common:

- Employees are penalized for mistakes (that may or may not be the result of their actions) in an environment of fear and blame
- Management regularly overrides key controls, and challenge is discouraged, bad actors can operate freely until their behavior becomes the norm
- Other employees who behave honestly may leave the organization or become corrupt themselves, resulting in further deterioration of the culture

The 2017 Fraud Examiner’s Manual (page 4.620) also discusses a common fallacy regarding ethics:

“A common fallacy in discussions about ethics is: If it’s legal, it’s ethical. A common defense to charges of unethical behavior is to invoke the law. This legalistic approach to ethics mistakenly implies that actions that are not explicitly prohibited by the law are ethical. The main error in this approach is that legal standards do not establish ethical principles. Although abiding by the law is a part of ethical behavior, laws themselves do not describe how an ethical person should behave. One can be dishonest, unprincipled, untrustworthy, unfair, and uncaring without breaking the law. Ethical people measure their conduct by basic principles rather than rules.”

**Takeaway:** Just because something is not against the rules does not mean it is ethical.
True Tales of Two Bosses

Which would you rather work for?

Boss #1: Mr. Martin had two cross-trained employees, one full time, one part time. When the full time employee went on maternity leave, the part time employee worked full time to keep up with the work. When the full time employee returned, backlog was minimal and normal work schedules resumed.

Boss #2: Mr. Wayne was the CEO of a 40+ person company. An employee of 12 years took maternity leave for an adopted newborn. When she returned, Mr. Wayne asked if she was going to resign to stay at home. When she said she couldn’t afford to resign, he suggested she go part time. When she went part time, she was laid off two months later. She was offered contractual work in exchange for a resignation, but soon after resigning she received an email saying her contract services were no longer required.
True Tales of Two Bosses

The rest of the story

Boss #1: Mr. Martin, intending to do right by his employees, simply did what he always did when one was absent, the other worked full time to cover. Had he consulted with Human Resources, he would have been advised that an employee with seniority from another unit was entitled to fill the position at a temporarily higher pay. The organization was required to pay back double pay to the employee from another unit. Mr. Martin was reprimanded and his previously unblemished work record was tarnished. He resigned.

Boss #2: Mr. Wayne was careful to consult with counsel to ensure his plans were legally executed. Policies clearly indicated part time employees were to be laid off before full time, and only full time employees get severance. The organization was under no legal obligation to maintain the contractual relationship. A signed letter of resignation supports the termination as voluntary. Mr. Wayne suffered no consequences for his behavior, aside from losing the trust and respect of his employees.
True Tales of Two Bosses

The moral of the story

Ethical people who inadvertently violate rules or laws are less likely to seek counsel and less likely to obscure their actions. Ethical people tend to be honest and admit their actions, and are far easier to scapegoat.

People who are aware that their actions may be unethical or perceived to be unethical tend to more carefully craft their plans and arrange their documentation to avoid consequence.

Key Takeaway: When you uncover wrongdoing, consider whether the perpetrator is an honest one.
Ethical Principles and Rules of Conduct

The IIA Code of Ethics offers a good example how principles relate to rules.

The four pillars are: **Integrity**, Objectivity, Confidentiality, and Competency.

**Principle of Integrity**: The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

**Rules of Conduct for Integrity**:

1.1. Shall perform their work with honesty, diligence, and responsibility.

1.2. Shall observe the law and make disclosures expected by the law and the profession.

1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.

1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.
The IIA Code of Ethics offers a good example how principles relate to rules:

The four pillars are: Integrity, **Objectivity**, Confidentiality, and Competency.

**Principle of Objectivity:** Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

**Rules of Conduct for Objectivity:**

2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.

2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.

2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.
Ethical Principles and Rules of Conduct

The IIA Code of Ethics offers a good example how principles relate to rules:

The four pillars are: Integrity, Objectivity, Confidentiality, and Competency.

**Principle of Confidentiality:** Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

**Rules of Conduct for Confidentiality:**

3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.

3.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.
The IIA Code of Ethics offers a good example how principles relate to rules:

The four pillars are: Integrity, Objectivity, Confidentiality, and **Competency**.

**Principle of Competency:** Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

**Rules of Conduct for Competency:**

4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.

4.2. Shall perform internal audit services in accordance with the International Standards for the Professional Practice of Internal Auditing.

4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.
The Core Principles, taken as a whole, articulate internal audit effectiveness. For an internal audit function to be considered effective, all Principles should be present and operating effectively. How an internal auditor, as well as an internal audit activity, demonstrates achievement of the Core Principles may be quite different from organization to organization, but failure to achieve any of the Principles would imply that an internal audit activity was not as effective as it could be in achieving internal audit’s mission**.

- Demonstrates integrity.
- Demonstrates competence and due professional care.
- Is objective and free from undue influence (independent).
- Aligns with the strategies, objectives, and risks of the organization.
- Is appropriately positioned and adequately resourced.
- Demonstrates quality and continuous improvement.
- Communicates effectively.
- Provides risk-based assurance.
- Is insightful, proactive, and future-focused.
- Promotes organizational improvement.

**Mission of Internal Audit**: To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.
Adhering to the IIA’s Code of Ethics, the Core Principles, and related guidance provides us with a road map for Auditing Culture, and promotes the credibility we need to do so.

**We must lead by example.**

Ethical Organizations exhibit the following cultural characteristics:

- **Positive tone from the top** – Executive management and the board work together to define the organization’s values and proactively emphasize and model those values.
- **Clear communication** – Management reinforces the values and culture through clear communication of expectations across the organization.
- **Open dialogue** – Management actively gathers and listens to feedback. All levels are open to constructive criticism and problem solving through methods such as employee suggestion/question program, ethics hotlines, open door policies, employees’ events and meetings, and more.
- **Employee engagement** – All employees (to the extent possible) are engaged in objective setting and strategy discussions.
- **Incentives aligned with core values** – All employees’ compensation, variable compensation, promotions, and other talent management are governed by a clear understanding of the organization’s core values and its risk appetite.
Steps to mitigate fraud are also effective at reducing other forms of misconduct, and improve ethical culture. Here, the Standards assign clear requirements.


- The Standards require the internal audit activity to assess fraud risks at the organizational and engagement level. To ensure adequate review of the risks relevant to each engagement, internal auditors should conduct a fraud risk assessment as part of engagement planning (AS 2210.A1). The process, while varying, generally includes the following steps:
  - Gather information to understand the purpose and context of the engagement, as well as the governance, risk management, and controls relevant to the area or process under review.
  - Brainstorm fraud scenarios to identify potential fraud risks.
  - Assess the identified fraud risks to determine which risks require further evaluation during the engagement.
- The internal audit activity is responsible for assessing the organization’s risk management processes and their effectiveness, including the evaluation of fraud risks and how they are managed by the organization (AS 2120.A2).
- Internal auditors must consider the probability of fraud when they develop the objectives of each engagement (AS 2210.A2).
- While internal auditors must have sufficient knowledge to evaluate the risk of fraud and how it is managed by the organization, they are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud (AS 1210.A2).
- When assessing fraud risks, internal auditors are expected to exercise due professional care (AS 1220.A1) and maintain an impartial, unbiased attitude (AS 1120).
Before we outline the audit of culture, an important take on fraud should provide useful. The Fraud Triangle is a well-known concept:

**Fraud Triangle:**
- Perceived Pressure
- Perceived Opportunity
- Rationalization

Developed by criminologist Dr. Donald Cressey
Who has heard about the Other Fraud Triangle?

The **Fraud Triangle**, also known as the **Fraud Motivation Triangle** is the conditions that typically exist before a fraud occurs.

There is also a fraud triangle that explains the components after a fraud occurs.

Do you know the legs of the **Fraud Element Triangle**?

1. No, I don’t know the legs of the Fraud Element Triangle
2. Yes, the legs are: Identify, Investigate, Implement Correction
3. Yes, the legs are: Commit Theft Act, Convert, Conceal
4. Yes, the legs are: Opportunity, Incentive, Rationalization
The Other Fraud Triangle:

The Fraud Element Triangle:
- Theft Act
- Conversion
- Concealment

Source: Dr. Steve Albrecht
Prevention, detection, and investigation strategies are usually in context of the two fraud triangles.

Opportunities from breaches in internal control can be found in the legs of the Fraud Element Triangle.
Opportunity is most determinant aspect of misconduct.

I believe perceived opportunities coincide with the three legs of the Fraud Element Triangle.

- Commit (Theft Act)
- Convert
- Conceal

Three Cs: Commit, Convert, Conceal

Even outside of fraud, the Three C’s are highly applicable to Internal Control.

Misconduct can only continue if all three legs of opportunity exist. Take away any leg, and the misconduct cannot persist.
While opportunity is the most determinant aspect of misconduct, pressure is the most compelling.

This makes logical sense. Pressure is what causes people to look for, entertain the possibility of, and ultimately act on opportunities. However, they will only commit misconduct if they find an opportunity.

While we obviously want to prevent misconduct, it clearly unhealthy for an organization to have demoralized employees under pressure seeking out opportunities for misconduct, especially if the an unethical organizational culture (real or perceived) promotes the rationalization.

Integrating both Fraud Triangles into an Ethical Culture
Some positive cultural characteristics from the IIA’s *Practice Guide on Auditing Culture* were previously listed. Now, let’s discuss some specifics to look for, in context of the phase of misconduct.

Let’s start with pressure, since this is where the misconduct starts. It can start with **Business Pressures** (compensation/commission, promotion, goals, boss, etc.) or **Personal Pressures** (debt, vices, affairs, family living, etc.). You should look for the following:

**Organizational:**
- Unreasonable or unachievable goals (financial, productive)
- Training (also addresses personal pressure and rationalization)
- Clear procedures, avoid or eliminate exception clauses
- Consider the organization’s unwritten rules including hierarchical norms and communication (scapegoating, fear)

**Personal:**
- Employee Assistance Programs
- Training (also addresses organizational pressure and rationalization)
- Pay, benefits
- Background checks (also rationalization)
Let's discuss rationalization. Pressure is what motivates one to start looking for or start entertaining opportunities, but most people who engage in misconduct need to be able to rationalize it before they cross the line.

Here are some things to consider:

Culture and Attitudes
- Can start early, both in hire and in the cultural formative years
- Management conduct, unfairness in terminations and reprimand
- “So much money is wasted”
- “I never get paid for all of my overtime”

What can we do to combat rationalization?
- Background checks (also uncovers pressures)
- Honesty checks
- Code of Conduct
- Trainings
- Set an example
- Culture of honesty, integrity – and hostility to fraud and misconduct.
- Tone at the top – treatment of staff vs treatment of management (executive raises during downsizing)
- Consequences
Ideally, we will not get to this point often, but the fact is you cannot eliminate all pressures and rationalizations. So, once someone is at the brink of misconduct, there are three opportunities that must exist:

- The **Opportunity to Commit** – simply put, if they cannot do it they cannot do it.
- The **Opportunity to Convert** – if they cannot convert the opportunity, the misconduct fails.
- The **Opportunity to Conceal** – if misconduct cannot *permanently* go undetected, the misconduct fails.

This is why I believe the Fraud Element Triangle is so important and I work it in to so many presentations. Preventing something from happening is just one step in internal control, yet it can present a single point of failure.

There is a quote that is applicable as well: “there are no small frauds, only big frauds that are caught early.”

For example, the person who will steal a small amount of money, will steal a large amount of money if they can get away with it. There is a great deal of value in strategically relying on detective controls in low risk circumstances in order to catch potential perpetrators early, before they are trusted in high risk circumstances.
Attributes of a healthy organization – Committing Misconduct

How much money is at stake and how is it controlled?
How much sensitive information is there, and how is it protected?
Are sufficient resources allocated to internal control?
Is there proper supervision?
Is there proper training, both for the employees and the supervisors?

Trust is both necessary and problematic:

• Trust: Most successful/expensive breaches of trust involve insiders, untrustworthy people that you don’t know you can’t trust.

• Collusion: No system can have perfect internal control, which can be circumvented by more than one employee working together. Relationships should be reasonably monitored.

• In the absence of personal relationships, we have no choice but to substitute security for trust, compliance for trustworthiness.

"Without trust, nothing can be achieved. Liars and Outliers is a brilliant analysis of the role of trust in society and business." [emphasis mine]

Klaus Schwab, Founder and Executive Chairman, World Economic Forum, praising Liars and Outliers: Enabling the Trust that Society Needs to Thrive, by Bruce Schneier
Attributes of a healthy organization – Prevent Conversion

One of the more difficult internal controls, but making resources more difficult to personal use to convert is a strong deterrent and detecting factor.

Cash
  Depends on what you use it for
  Organizations should not deal in large sums of cash

Checks

Credit Cards

Business resources

Sensitive information
  Tax information
  Health information
  Payroll

Value reducing protocols
  Remote wiping of devices
  Anti-theft devices on merchandise
Attributes of a healthy organization – Prevent Concealment

- Complex organizational structures
- Record Keeping
- Monitoring (also deters committing)
- Whistleblowing
  - Hotlines
  - Whistleblower protection
- Monitor interpersonal relationships
  - Collusion
- Mandatory vacations
- Prenumbered documents
- Job rotation / Independence checks
- Surprise audits

Failure to detect and punish misconduct is demoralizing to honest employees, and increases rationalization

*Tips are most common method of initial detection*
Here are some fraud facts from the ACFE Report to the Nations:

- Asset misappropriations (most frequent)
- Financial statement fraud (greatest median loss)
- Owners/executives cause losses 4 times higher than managers
- Only 5% had previous conviction
- Living beyond means/financial difficulty most common behavioral red flags

A major company vice president was convicted of embezzling a few hundred thousand dollars.

- It sounds significant, until you realize he was making $6 million per year.
- What financial pressure could he have been under?
- What is the affect on employee morale, rationalizations?

Imagine a CEO with compensation totaling over one half billion (with a B) dollars over a five year period, during which time over 4,000 employees were laid off.
In previous slides, we discussed the importance of internal auditors “walking the talk,” leading by example, and building credibility for the role as a trusted advisor. This is an important prerequisite for auditing culture.

According to the IIA’s Practice Guide for Auditing Culture, here are some good advisory services:

- **Identifying root causes** - not only for areas that have received observations and recommendations from internal audit regarding culture but also for areas judged as operating with best practices. Identifying and analyzing root causes from both perspectives results in powerful tools to gauge frequency and assess how cultural elements are drivers of results in improvement of affected areas.
- **Assessing the governance structure** (roles and responsibilities) related to culture and conduct.
- **Assessing the organization’s programs** for communicating values, strategies, and objectives.
- **Assessing the effectiveness of culture-related trainings** including code of conduct, ethics, sexual harassment, etc. (e.g., How seriously do employees take the training? Are the delivery methods effective?)
- **Performing internal audit engagements** that consider employee incentive and hiring programs, disciplinary actions, and escalation protocols, treatment of “whistleblowers” or employees that speak up and escalate issues and other key performance indicators (KPIs) or key risk indicators (KRIs) that may be relevant to the organization’s culture.
- **Analyzing information** related to culture gathered for other purposes in the organization (e.g., analyzing and trending employee survey data).
Attributes of Internal Audit

To fulfill the roles described on the prior slide, the IIA’s Practice Guide for Auditing Culture emphasizes the following attributes for internal auditors assigned to culture-related risk audit engagements. Internal auditors leading culture-focused engagements should be:

• Familiar with the organization’s unwritten rules including hierarchical norms and how employees from different levels communicate with each other.
• Skilled at reading body language and “reading the room” to ensure nonverbal cues are considered appropriately.
• Experienced and/or respected enough in the organization to be able to ask hard questions that may touch on uncomfortable subjects.
• Focused on the objective facts of an engagement rather than their personal feelings about the people or processes involved.

Again, the importance of the credibility of internal audit cannot be overstated.
Conducting Remote Interviews

The previous slide discussed the importance of reading body language. The current, COVID-19 environment must be considered. When possible, use video conferencing, to help read non-verbal cues.

The Journal of Accountancy offers tips:

**Tip 1: Wear headphones.** Yes, your computer has speakers, a microphone, but there seems to be someone in every meeting causing an echo.

**Tip 2: Use mute as much as possible.** Background noise (dog barking, talking, typing, shuffling papers) can be incredibly distracting and disruptive to meetings. A common reason people don’t mute is that they often forget to unmute.

**Tip 3: Join the meeting a few minutes early.** Remote meetings often start late because attendees are not ready at the start time.

**Tip 4: If joining audio via the phone bridge, don’t skip entering your audio PIN.** It not only helps identify you to others, it saves time because people don’t have to identify themselves every time they start a sentence.

**Tip 5: Think about your camera placement.** Place your camera in front of you and as close to eye level as possible. Nobody wants to look at the top of your head or up your nose during the meeting. Your remote eye contact will be much more effective if they can see your eyes.

As a general rule, try to end your meetings on time as a courtesy to those who have set aside time on their calendar for you. Ideally, end early to give them back time.

Impact of COVID-19 on Internal Audit

The impact of changes in 2020 on culture cannot be ignored. According to an IIA Global Knowledge Brief:

- Almost 4 in 10 internal audit functions experienced initial budget cuts.
- About 2 in 10 experienced internal audit staffing/outsourcing cutbacks.
- Staffing decreases were almost three times more likely to be described as temporary than permanent.
- More than a quarter of respondents did not agree that organizations were appropriately involving internal audit in discussions about COVID-19 risk.
- About 6 in 10 said their functions updated audit plans, identified emerging risks, and reviewed risk assessments.
- About 5 in 10 canceled audit engagements and 4 in 10 added new engagements.
- In response to COVID-19, almost one quarter redirected audit staff to do non-audit work.

As noted on the prior slide, COVID-19 has drastically altered how organizations do business, and how we audit. We must define a remote audit:

- A remote audit is an audit that is conducted partially or completely off site, generally using technology when a site visit is not possible or appropriate.
- COVID-19 accelerated the movement of the auditing profession toward using remote techniques to perform engagements.
- Remote auditing has long been a challenging topic for the profession because of the belief that auditors may be more likely to discover fraud, malfeasance, or simple mistakes when they visit a site.
- Engage IT as early as possible; consider capabilities and limitations in planning.
- Use all the technology at your disposal to avoid missing anything.

When performing remotely, auditors have the same obligations to comply with standards and deliver high quality as they would when working on-site.

The COVID-19 Environment is also an Opportunity

During time of crisis, ask if internal audit can be helpful.
  - Some people need left alone to an extent.
  - Is an audit at this time feasible and appropriate?
  - Be considerate of auditees other priorities and major deadlines.

This will not only affect how we audit, but what as well.
  - Affects your documented risk assessment and audit plans.
  - Should assess what is achievable remotely.

Plan in order to prevent frustrating surprises.

Agreement on how information will be shared.

Legal and related considerations
  - Recording meetings
  - What constitutes a quorum under applicable laws.
  - Security and privacy
  - Photos and videos

COVID-19 gives internal audit an opportunity add value and be a trusted advisor.
A real cultural risk internal audit may face is pressure to change audit findings. According to a June 2014 survey for the book *The Politics of Internal Audit*, internal audit faced the following pressures:
Sources of Pressure on Internal Audit

According to a CBOK 2015, Global Practitioner Survey, the following were sources of pressure:

- CEO (or head of government agency): 38%
- Operations management: 35%
- Legal or general counsel: 19%
- Internal audit department: 14%
- Chief financial officer (CFO): 14%
- Other internal source: 8%
- Other external source: 8%
- I prefer not to answer: 3%

How would internal audit be regarded in a culture where it can be manipulated by these sources?
It is very important to distinguish between legitimate disagreement and pressure.

- Yielding to legitimate challenge or disagreement may be acceptable, and may enhance internal audit’s credibility and their role as a trusted advisor in promoting an ethical culture.
- Yielding to inappropriate pressure will not only diminish internal audit’s credibility, it will add to the organization’s cultural decay. If internal audit cannot stand up to unethical culture, who can or will?
Managing Pressure

Prepare

• Handle it before it occurs.
• Paying attention to signs
• Think through potential situations
• Developing plans to address issues
• Communicate concerns without delay
• Journal of Accountancy suggestions:
  ➢ Be sensitive to culture, understand it can change, be politically astute and aware. Don’t get caught off guard!
  ➢ Demonstrate a knowledge of the business, and convey audit findings from management’s perspective.
  ➢ Anticipate pressure, and build strong relationships ahead of time to understand rationale and incentives.
  ➢ Acknowledge the effect of the audit finding on the organization — work thoroughly, continuously, and objectively, and align internal audit with the organization.

Respond

• Despite the challenges faced by public sector internal auditors, it is crucial that they work with managers (and public officials) to develop effective programs.
• When faced with even the slightest level of pressure to suppress findings or to commit an unethical act, an expression of strength and professionalism, and display of integrity, is vital.
• It is crucial that the CAE be willing to address the situation head-on (even if the pressure originates from senior executives, or if their position is threatened), provide the documentation and evidence needed to support their conclusions, discuss those conclusions, and ultimately stand their ground.
• Yielding to even a minimum amount of pressure can open the door for more forceful attempts.

Source: www.theiia.org/psac
According to a June 2012 informal survey by the IIA Public Sector Committee, common and best practices in disseminating and publishing audit reports:

- Most public sector entities disseminate the internal audit report to an audit committee or senior management.
- Most entities strive to be transparent in regard to the internal audit report, but most do not publish reports on an intranet or Internet.
- Federal/national governments are less likely than lower levels of government to disseminate internal audit reports to internal parties, including impacted management, except to the board or audit committee.
- Only a small portion of public sector entities are externally transparent, but most entities disseminate to external auditors.
- All entities that disseminate internal audit reports to an external party also disseminate these reports to senior management and/or legal counsel.
- Higher levels of government are less likely to publish audit reports on an intranet and/or Internet, and the lower levels are more likely to be transparent to the public through Internet report publication.
- Entities that follow The IIA’s Standards are less likely to publish the internal audit report on an intranet and/or Internet.
- Entities that are subject to public information laws are more transparent in publication of the internal audit report.

Consider how your reporting environment, such as public vs private, affects your influence on culture.
According to the IIA Practice Guide: Engagement Planning Assessing Fraud Risks:

- “As a work around…”
- “Just this one time…”
- “I have always done it this way.”
- “Once in a while we…”
- “Off the record…”
- “There are no policies or procedures for this process.”
- “Someone told me to do it this way; however, I am not sure why.”
- “This is really how it is done.”
- “The way it is supposed to work…”

Corollary: While “always done it this way” is not a good explanation, it is also not a good reason to stop. Before you remove a control or a procedure/practice, it is wise to find out why it is done this way. It may have been implemented for a good reason that has since been forgotten.
The ACFE Report to the Nations highlights some red flags of misconduct, most notably fraud. These are always applicable, but many will be heightened in the COVID-19 environment:

- Living Beyond Means: 45.8%
- Financial Difficulties: 30.0%
- Unusually Close Association with Vendor/Customer: 20.1%
- Wheeler-Dealer Attitude: 15.3%
- Control Issues, Unwillingness to Share Duties: 15.3%
- Divorce/Family Problems: 13.4%
- Irritability, Suspiciousness or Defensiveness: 12.3%
- Addiction Problems: 10.0%
- Complained About Inadequate Pay: 9.0%
- No Behavioral Red Flags: 8.8%
- Refusal to Take Vacations: 7.8%
- Excessive Pressure from Within Organization: 7.0%
- Past Employment-Related Problems: 6.8%
- Social Isolation: 5.9%
- Past Legal Problems: 5.6%
- Other: 5.5%
- Excessive Family/Peer Pressure for Success: 5.1%
- Complained About Lack of Authority: 4.4%
- Instability in Life Circumstances: 4.3%

• MYTH #1
  Internal control starts with a strong set of policies and procedures.

• FACT #1
  Internal control starts with a strong control environment.

Source: IIA PIAB, Controls are Everybody’s Business
• MYTH #2
  Internal control: That’s why we have internal auditors!

• FACT #2
  While internal auditors play a key role in the system of control, management is the primary owner of internal control.

Source: IIA PIAB, Controls are Everybody’s Business
Myths vs Facts

• MYTH #3
  Internal control is a finance thing.

• FACT #3
  Internal control is integral to every aspect of business.

Source: IIA PIAB, Controls are Everybody’s Business
• MYTH #4
  Internal controls are essentially negative, like a list of “thou-shalt-nots.”

• FACT #4
  Internal control makes the right thing happen the first time - and every time.

Source: IIA PIAB, Controls are Everybody’s Business
• MYTH #5
  Internal controls take time away from our core activities of serving constituents.

• FACT #5
  Internal controls should be built “into,” not “onto” business processes.

Source: IIA PIAB, Controls are Everybody’s Business
MYTH #6
With budget cuts, downsizing and empowerment, we have to give up a certain amount of control.

FACT #6
With budget cuts, downsizing and empowerment, we need different forms of control.

Source: IIA PIAB, Controls are Everybody’s Business
• MYTH #7
  If controls are strong enough, we can be sure there will be no fraud, and financial statements will be accurate.

• FACT #7
  Internal control provides reasonable, but not absolute assurance that the entity’s objectives will be achieved.

Source: IIA PIAB, Controls are Everybody’s Business
Questions and Answers

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