

## ETHICAL DILEMMAS

What rationalization does a company make to justify a corporate culture where ethics are ignored? In recent years, greed, fraud, and a lack of ethical conduct have led to the collapse of many organizations. A variety of internal and external pressures can lead companies down the wrong path. And once the first misstep is taken, it's a slippery slope to hurting stakeholders, the community, and your reputation.

This turmoil and damage could have been avoided if organizations had chosen to maintain an ethical corporate environment, exercising integrity-rich behavior and ensuring the tone at the top was above reproach. This issue of *Tone at the Top* presents suggestions for creating and promoting an ethical corporate climate and the role internal auditors can play in helping ensure the environment supports ethical decisions and behavior.



### Code of Ethics

It's important to note that internal auditors adhere to their own Code of Ethics, which is included in The IIA's International Professional Practices Framework (IPPF). The Code of Ethics mandates that internal auditors behave and practice with:

- Integrity.
- Objectivity.
- Confidentiality.
- Competency.

It also delineates rules of conduct under each of the principles. A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about governance, risk management, and control.

## Ethical Values

According to the Institute for Global Ethics (IGE), five ethical values exist in any human culture, regardless of age, religious affiliation, gender, or nationality. Those values — which play a role in all dealings, transactions, relationships, and situations — comprise being:

- Honest and truthful.
- Responsible and accountable.
- Fair and equitable.
- Respectful and mindful.
- Compassionate and caring.

Just imagine how choices might be altered if every organization made a conscious decision to embrace and foster these five values, and if everyone, individually and collectively, made a concerted effort to incorporate them in all of their encounters and actions.

The IGE works to “explore the global common ground of values, elevate awareness of ethics, provide practical tools for making ethical decisions, and encourage moral actions based on those decisions.” The institute provides case studies — such as the one included here — of a broad range of dilemmas that can be used to explore how individuals and groups might react when faced with making a decision that challenges their ethical code.

## Case Study: A Lack of Outrage

Larry is a young port engineer who works energetically for his shipping company, overseeing repairs and related projects. He is proud when put in charge of a multi-million-dollar repair order for one of his company’s ships. The repairs are contracted out to a major shipyard, and everything goes smoothly until the end of the project. When Larry is handed the bill, he realizes it has been inflated by about one-third of total project costs.

Larry is shocked. He has never been confronted by such an apparently corrupt practice before. After delaying the “sign off” for a couple of days, he approaches his boss, points out what is going on, and explains why he cannot sign off. His boss asks for specifics, which Larry readily supplies.

A meeting is arranged between shipyard and shipping company officials, who go over the disputed items. They agree the shipping company is being overbilled by millions of dollars. To Larry’s surprise, however, there is little reaction from either side of the table. Nor is there any definitive, ethical stance from his company.

The meeting adjourns until the next day, when shipyard officials meet again and this time offer to split the difference. For approval, both parties turn to Larry who explains

## An Ethical Culture

According to the U.S. Federal Sentencing Guidelines, a company with an “effective” compliance and ethics program exercises due diligence to prevent and detect criminal conduct and promotes a culture that encourages ethical conduct and commitment to compliance with the law.

SOURCE: *Audit Committee Effectiveness: What Works Best* — 4th Edition

Several practices management can use to monitor the ethical tone of the organization include conducting employee surveys, holding discussions with Human Resources to review upward feedback from staff, and implementing a way to review employee complaints,

such as a confidential whistleblower hotline. According to the U.S. Sarbanes-Oxley Act of 2002, Section 301, each audit committee shall “establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls or auditing matters; and the confidential anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.”

Internal audit often is involved in the creation of an anonymous hotline, asked to monitor and assess its effectiveness, and sometimes serves as the clearinghouse for investigating hotline tips. Several essential phases in hotline development include marketing to build awareness, ensuring accessibility for ease of use, and the timely and effective handling of reported issues.

he cannot sign off on the adjusted bill. Again, the meeting adjourns with no apparent reaction, and Larry is left in a daze.

By the time of the third meeting, Larry begins to piece things together. Apparently his superiors respect his integrity. They are following orderly procedures to arrive at a final bill. But he cannot help noticing their lack of outrage and conviction. What drives them to such a compromise?

(*Institute for Global Ethics, 2012*)

## A Clear Tone

Larry is left wondering about the tone at the top of his organization. Is he out of step with the corporate culture? Will he be protected if he vehemently expresses his disapproval and outrage?

According to The IIA Research Foundation's study, *Audit Committee Effectiveness: What Works Best — 4th Edition*, culture and compliance are the “soul of accountability” and tone at the top is about “creating a culture where everyone feels responsible for doing the right thing.” Although the board of directors is responsible for overseeing the tone at the top, the board's audit committee is key to discerning whether the purported tone actually permeates the entire organization.

Internal auditors can assist the audit committee by assessing whether policies are being followed or are ineffective, expose fraudulent activities that could have devastating repercussions on the organization, and identify operational problems like those Larry discovered. They can be the eyes and ears of the board. In some organizations, the auditors assess the entire ethical environment and determine whether the practices, policies, and procedures in place are ethical and effective, and that they contribute to a strong internal control system.



## Whistleblower Protection

Provision for anonymity to any individual who willingly comes forward to report a suspicion of fraud is a key to encouraging such reporting and should be a component of the organization's policy. The most effective whistleblower hotlines preserve the confidentiality of callers and provide assurance to employees that they will not be retaliated

against for reporting their suspicions of wrongdoing, including wrongdoing by their superiors. Another key is demonstrating that their reporting will



result in appropriate and timely action being taken. To preserve the integrity of the whistleblower process, it must also provide a means of reporting suspected fraud that involves senior management, possibly reporting directly to the audit committee.

SOURCE: *Managing the Business Risk of Fraud: A Practical Guide*, a joint-project, sponsored by The Institute of Internal Auditors, the American Institute of Certified Public Accountants, and the Association of Certified Fraud Examiners

## Corporate Accountability

Clearly, there are many ethical dilemmas in today's business environment, and it's not always easy to determine the right course of action. This is one reason an ethical tone at the top is critical to an organization's long-term success.

When those at the top adhere to and promote a strong ethical code with clearly stated values, they have taken the first step toward creating a corporate culture in which employees follow suit. And when they make sure bad things don't happen to employees like Larry, who step forward and blow the whistle on inappropriate activities, they send to all stakeholders a clear message of unwavering ethics and accountability.



# TONE *at the* TOP

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## About *Tone at the Top*

*Tone at the Top* provides executive management, boards of directors, and audit committees with concise, leading-edge information on issues such as ethics, internal control, governance, and the changing role of internal auditing. It delivers relevant and timely guidance regarding the role and responsibilities for internal auditing. Email your comments about *Tone at the Top* to [PR@theiia.org](mailto:PR@theiia.org) or call +1-407-937-1247.

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## New Year — New Look. More for You!

For the past two decades, *Tone at the Top* has been exploring a wide range of risk, control, and governance matters facing governing bodies and internal auditors. During that time, the world and the internal audit profession have changed a lot—and we're changing, too. We're excited to unveil a new look for *Tone at the Top*, as well as an increased distribution frequency. Instead of our quarterly publication, you can now look forward to reading new issues in February, April, June, August, October, and December. To view our online archive, visit: [www.globaliia.org/knowledge/Pages/Tone-at-the-Top.aspx](http://www.globaliia.org/knowledge/Pages/Tone-at-the-Top.aspx).

