Five Ethical Dilemmas facing Internal Auditors – Find out how you can help?

By Ajay Nand

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

Ethics is defined by Chambers Dictionary as "code of behaviour considered correct".

The primary purpose of the Code of Ethics issued by the Institute of Internal Auditors (IIA) is to promote an ethical culture in the profession. It is necessary and appropriate for the profession as it is founded based on the trust placed on its objective assurance on governance, risk management and control.

IIA Code of Ethics extends to include two very essential components, *principles* which are relevant to the practise and profession of internal auditing and *Rules of Conduct* which describe behaviours and norms expected of internal auditors. Internal auditors include members of IIA, recipients of or candidates for IIA professional certifications, and individual and entities which perform internal audit services within the Definition of Internal Auditing.

IIA Code of Ethics applies to individuals and entities that perform internal audit services. The Code of Ethics is administered by Internal Audit Institutes and breaches are administered under Institute By-laws. Serious breaches may result in disciplinary action being taken against internal auditors and reported to the global body.

Internal auditors *face ethical issues* during the course of their roles and responsibilities on a daily basis. Some of these issues are:

1. Prevention of Lawful Disclosure

Most organisations and firms are required by legislation to disclose financial and non-financial results to state agencies which may include regulators or law enforcement agencies. To provide the required assurance internal auditors must review the information before it is released. In most cases, internal auditors are prevented from reviewing such information or where they are allowed, errors and omissions are not corrected prior to submission.

In addition, companies have strict policies for reporting suspected criminal activities or breaches of law which prevent internal auditors to directly report them. If internal auditors do report them, they can be disciplined for breaching company's policies relating to release of confidential information.

2. Pressure from Management

Pressure from Management may be in many forms sometimes direct and in most cases indirect which may be termed as "in the best interests "of the organisation or firm. Direct pressure could be made on Head of Internal Audit to change the content of audit reports or papers to Audit Committees if the contents do not reflect favourably on Management.

Indirect pressure could be in the form of not supporting the internal audit function to adopt the International Professional Practices Framework for Internal Audit (IPPF) issued by IIA Global which mandates independence of the function and restricts influence by Management. Instances have also been noted where Management has made changes to policies which make it difficult for internal audit functions to receive funds for continuous professional development.

Internal auditors are also under continuous pressure to "strike the balance" between their independence as auditors and provide support to Management in operational duties such as assisting in tender evaluations, participating in employee recruitment process and disciplinary tribunals. Heads of Internal Audit functions are seen to be uncooperative and lacking in strategic drive if they decline to release internal auditors for these duties.

3. Influencing objectivity and integrity of internal auditors

Internal Auditors are like any other employee of an organisation or firm. They have career aspirations, dreams to live and families to support. Their role in the internal audit function makes them more vulnerable. The Human Resources Department is responsible for processing of training applications, promotions, payroll and benefits for all employees including internal auditors.

It is common for the HR Department to significantly delay of processing of training requests, promotions and benefits for internal auditors. In some cases, reduced salaries and benefits may be accorded to internal auditors and justified by their own interpretation of the HR policies. Some internal auditors may perceive these actions as a direct result of their audit of the HR Department's activities.

A poorly resourced internal audit function is unable to perform its fundamental objectives. In some cases, the HR Department may delay in processing of vacancies or creation of new positions. Due the vast knowledge of the institution or firm business, senior internal audit staffs may also be offered higher-paying jobs in other Business Units which can weaken an internal audit function.

4. Delay by Management in timely completion of audits

Management plays a critical role in timely completion of audits. However, timely completion of audits may be affected when information or records required for audit purposes are not released promptly or responses required from Management are unnecessarily delayed. Sometimes Management may withhold or delay release critical information which should generally be provided, on the basis of confidentiality or sensitivity.

The reason for such delays can sometimes be attributed to preventing release of the final audit report to the Audit Committee or implementation of audit recommendations especially those made in draft reports, prior to finalisation of the audit report.

5. Internal auditors failing to maintain independence

Everyone who joins the internal audit profession is responsible for maintaining the IIA Code of Ethics. Personal greed should not overcome the independence and integrity of internal auditors. In many instances, internal auditors engage in activities which conflict with their roles and responsibilities while others give in to pressure from Management to amend or ignore facts.

Internal auditors have also found to have released confidential information which came to their knowledge during the course of their audits to unauthorised persons within or outside an organisation or firm. On certain occasions, internal auditors have used confidential information within the internal audit function to discredit their colleagues for personal gain or please Management.

IPPF holds Head of Internal Audit functions or Chief Audit Executives responsible for professional development of internal auditors. However, internal auditors prefer to continue their professional development in their primary qualification such as accounting and finance. Hence in the process, they have refused to utilise the funding made available by some employers for their professional development in internal auditing.

Some internal auditors have also engaged themselves in audit of areas or functions in the organisation or firm despite not being proficient.

Ajay Nand in panel discussion on Emerging Ethical Issues facing the Profession – 2015 ACIIA Annual Conference, Manila, Philippines.

There are a number of *key contributors to ethical breaches* which include internal auditors (individuals), internal audit service providers, internal audit institutes, and Audit Committees. These are discussed in detail below.

1. Internal Auditors (individuals)

A number of individuals who are engaged in internal audits are not members of IIA hence lack knowledge on ethical requirements described in the IIA Code of Ethics. In addition, internal auditors are employees hence are vulnerable to threat of job loss if they do not follow the instructions provided by Management. As individuals, some display personal greed by trying to gain financial or non-financial unfair advantage.

The internal audit profession encourages internal auditors to adopt IPPF. In most cases, internal auditors lack initiative to promote the use of IPPF in their respective institutions which would enhance their roles and responsibilities especially where independence is concerned.

Finally, there are incidents where internal auditors are influenced from independently carrying out their roles and responsibilities or where they breach IIA Code of Ethics which are not reported to Audit Committees.

2. Internal Audit Service Providers

A number of service providers which provide internal audit services are yet to adopt the IPPF although they are bound to comply with the IIA Standards and Code of Ethics in carrying out the audit services. Sometimes costs of adoption IPPF and requirement to have periodic internal and external quality assessments are key contributing factors for non-adoption.

Although a significant number of service providers are providing internal audit services, only a handful of their employees are members of the IIA.

3. Internal Audit Institutes

Internal Audit Institutes play an integral role in ethics management. However, in most cases, the Institutes do not carry out awareness on IIA Code of Ethics in seminars and annual conferences which are organised and are attended by a large number of members and non-members. In addition, there are no established procedures for reporting of breaches to the Institute or where breaches are reported, there is lack of appropriate action. Institutes also do not have any legal jurisdiction over non-members or service providers who provide internal audit services to enforce the IIA Code of Ethics.

4. Audit Committees

Audit Committees are placed at a very strategic position in organisations and can play a very important role in promoting ethics. However, in most cases, Audit Committees do not promote the adoption of IPPF and the IIA Code of Ethics by internal audit functions which report to them. Some Audit Committees are not seen to be vigilant as far as internal auditor ethics is concerned while others fail to take appropriate action where breaches by internal auditors or undue influence on auditor independence by Management are reported.

There are several ways in which *ethical issues can be effectively dealt*. Again the key players which can assist in dealing with ethical issues include Audit Committees, Head of Internal Audit functions, partners of firms providing internal audit services, internal auditors, internal audit institutes and peers. Some of the ways in which they can assist are discussed below.

1. Internal Audit Institutes

Internal Audit Institutes have fundamental responsibility of creating awareness on IIA Code of Ethics and set up avenues for reporting and dealing with breaches of Code of Ethics. Institutes should also publish actions taken against offenders for breaches of Code of Ethics so that it acts as deterrence to future offenders.

All Institutes should have sessions on IIA Code of Ethics in annual conferences which are also attended by delegates from all major professions. The discussions and presentations could focus on the ethical requirements of internal auditors and expectations from Management where they are employed.

Peers and mentors in the profession should also provide guidance and support to internal auditors facing ethical dilemmas.

2. Heads of Internal Audit Functions/ Internal Audit Service Providers

Heads of Internal Audit functions or service providers should bring to the attention of the Chief Executive Officer and the Audit Committee any potential ethical issues relating to internal auditors or Management. They should carry out awareness on IIA Code of Ethics in their respective internal audit functions/firms and companies/ organisations where internal audit functions are based or where internal audit services are provided.

Heads of Internal Audit functions or service providers should also promote the use of IPPF so that internal auditors are able to reference their practise to international standards and best practises.

3. Internal Auditors (individuals)

Since loss of job and regular income source is a major threat to internal auditors facing ethical dilemmas, it is necessary for them to commence saving early in their careers. This would prepare them to stay firm when placed in pressure situations either by Management or by fellow internal auditors.

Internal auditors should also engage early in the certification programs run by IIA Global. Professional development will not only prepare them for higher positions in the respective internal audit functions but will instil confidence and belonging to the profession.

4. Audit Committees

Audit Committees can assist in the promotion of IIA Code of Ethics by taking a firm stand on any reported breaches. Committees should have private meeting with the Head of Internal Audit at least once annually. The agenda for the meeting should include matters relating to ethics. They should promptly act on any reported breaches of ethics or unethical attempts to influence the judgement of internal auditors.

Audit Committees should also support professional development of internal auditors by endorsing training and professional development budgets,

While ethical issues will continue to exist, internal auditors should prepare themselves early in their careers to deal with ethical dilemmas. Internal Audit Institutes, Heads of Internal Audit functions and service providers and Audit Committees should work together to support, encourage and guide internal auditors to comply with the IIA Code of Ethics. Any attempts made to influence internal auditors to breach the Code of Ethics should be viewed very seriously by Audit Committees and stringent action should be taken against persons involved.

Ajay Nand is the immediate past President and member of IIA Fiji Board. He was invited to be part of a panel by ACIIA who met all costs of his travel and accommodation as part of assistance to small and developing institutes. The views and opinions expressed in this article are not necessarily those of IIA Fiji, ACIIA or Fiji National Provident Fund where he is employed as Manager Internal Audit.