

**AUDIT OFFICE OF  
THE REPUBLIC OF CYPRUS**

**ENHANCING STAKEHOLDER CONFIDENCE:  
AUDITING MANAGEMENT INTEGRITY, ACCOUNTABILITY  
AND “TONE AT THE TOP”**

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### **Integrity and Ethical Behaviour of Audited Agencies.**

Integrity in an organization requires directors, managers and employees to be honest, have high standard of behaviour and truthfulness, be of good character, observe the principles of equity and conduct themselves in an ethical manner.

In an audit it is of paramount importance that the auditor assesses the internal control of the auditee including Management Integrity, Accountability and the so called "Tone of the Top" so as to assess the likelihood of error or fraud taking place..

"Tone of the Top" refers to ethical attitude or atmosphere that is created in the organization's leadership or upper management. If the Tone set by upper management is to uphold ethics and integrity there is a strong case that the rest of the employees will also be ready to follow these values. On the other hand, if upper management is unconcerned about ethics and integrity, employees will be inclined to follow along the same lines, thereby weakening the organization on these values and be less hesitant to commit fraud. In such a case, the internal control on this area will be weak necessitating alternative audit procedures.

History has shown that in certain cases upper management greed has created many problems in organizations even in some cases destroyed them thereby diminishing or eliminating the stockholders investments. It is thus important for the auditor when assessing an organization to be audited to look at management and weigh its attitude towards integrity, accountability, independence and the tone that it sets at the top on these values. It is true that every organization, public or private, must set up its goals in a given period. It is important that such goals are not unrealistic, otherwise there is the danger that both management and employees may try to achieve these goals, through improper or fraudulent means, since unattainable goals or targets cannot be achieved through normal legal methods and procedures.

It is therefore essential that top management do not set up unrealistic goals and give full instructions of what is expected from its employees.

Conversely any undue pressure by upper management on the employees to meet unattainable goals or targets will create confusion and can lead to actions on the part of the employees, in their endeavors to meet these goals, which can be unethical, unequitable even in certain cases fraudulent. The same can happen when upper management, middle management and employees alike receive bonus or compensation or incentives in meeting targets. Meeting realistic targets through incentives such as compensation or bonus poses no real threat while on the other hand trying to meet unrealistic targets so that bonuses can be received often leads to wrongdoing, manipulations of records unethical behaviour and fraud. As such auditors must look at an organization's bonus structure to ensure that bonuses are not yielding an undue influence on the management and employees.

In any entity to be audited the auditor needs to find whether there is any misconduct from upper management, middle management and employees alike and if there is the degree of such a problem. This is essential by the auditor in assessing the internal control procedures, its adequacy effectiveness and applicability throughout the period to be audited, so as to decide on the extent of the likelihood of errors or misappropriation of funds or misconduct or fraud taking place and therefore deciding on the form extend and content of the audit to be carried out.

According to a National Business Ethics and Integrity Study, carried out in 2005, it was pointed out that the determinations of ethical behaviour within an organization are:

- (i) Behaviour of Superior
- (ii) Behaviour of Directors
- (iii) Industry ethical practices
- (iv) Society moral climate
- (v) Formal organization policy

### **Important Considerations for Stakeholders**

When critically examining an organization's successes it is necessary to keep the stakeholder interests in mind. In ourdays stakeholders take a close look of the reputation and perceived integrity, accountability and ethical factors of an organization as part of their overall assessment of the

organizations. It is therefore important that organizations weather government or private take appropriate steps to establish integrity and accountability and to convey that to stakeholders and staff. Such steps can be:

- Establish a code of ethics within the organization carefully monitoring its application.
- Set an ethical tone of the top. Upper management has to give the good example. Unethical actions should be punished.
- New applicants must be screened for good moral values.
- Train your employees to detect and to prevent fraud, as well as to apply the applicable standards at work.
- Have disciplinary measures for ethical violations.
- Give clean instructions as to who has the authority and the responsibility.
- Establish a whistleblown policy, i.e. organizations must have a whistleblower production policy to allow employees to come forward and report misconduct in the organization. This is not an easy task as employees feel reluctant to criticize their organization and its management.

It is essential that management as well as the external auditors evaluate antifraud processes and controls within the organization by identifying and measuring fraud risks mitigating or if possible abolishing such risks. Prioritization of such risks is essential depending on the degree of risks assessed. Most risks can be mitigated if there is a proper internal control system.

### **Conclusion - New Developments.**

In concluding, we have to remember that Auditing Management Integrity Accountability and "Tone at the Top" is not an easy task. At the core of management integrity is the belief that organizations should have a strong interest as well as the responsibility to act with integrity of all times. The financial crisis has also brought new dimensions in the field of audit.

Media attention given to ethical lapses means that organizations are increasingly being held responsible for unethical behaviour including corruptions and labours issues. According to Transparency International

which investigates business corruption universally, bribery and corruption were partly to blame for the recent global economic crisis. The condition cited include serious lapses in organizations due diligence, governance and integrity, poor transparency and accountability.

Stricter legal framework have made it easier to prosecute wrongdoers and new international initiatives are helping countries to work in collaboration to deter poor business ethics. New legislation in the United States undergives some of the reasons organizations are taking integrity seriously and enlisting integrity management consultants who help organizations on ethical business decisions, public relations practices, compliance with applicable legislation, apply social responsibility and others.

Consequently, auditors are now required to simply do more audit and the audit of Integrity and accountability is not any more rare in the annual audits performed by state or private auditors. In recent years the stakeholders and the public at large have become better informed and more concerned and demanding about Integrity Accountability and the so called "Tone at the Top". As a result, governments have been called upon to legislate, and Upper Management to innovate, to ensure that high ethical standards are in force within their organizations.

It is my firm belief that in the non distant future we will see more stringent auditing standards than those existing now covering Integrity, and Accountability, and an increased responsibility from external auditors to report on the integrity and ethical values of audited organizations. Accordingly, the accounting/auditing profession must be ready to change and meet this challenge, the coming of which has been accelerated by the current, almost worldwide, financial crisis and the strong demand of stakeholders and the public at large to be better informed. Similarly Parliaments will exercise a more thorough Parliamentary control on governments entities and demands will emerge from National Parliaments and N.G.Os for new legislation covering management responsibilities, ethics, integrity and accountability both for government agencies and private companies.