Ethics and Pressure

Balancing the Internal Audit Profession

GOVERNANCE

Closer Look

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The IIA Research Foundation

CBOK
The Global Internal Audit
Common Body of Knowledge

Sponsored by

Larry Harrington, CIA, CRMA, QIAL
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About CBOK

SURVEY FACTS

Respondents	14,518*
Countries	166
Languages	23

EMPLOYEE LEVELS

Chief audit executive (CAE)	26%
Director	13%
Manager	17%
Staff	44%

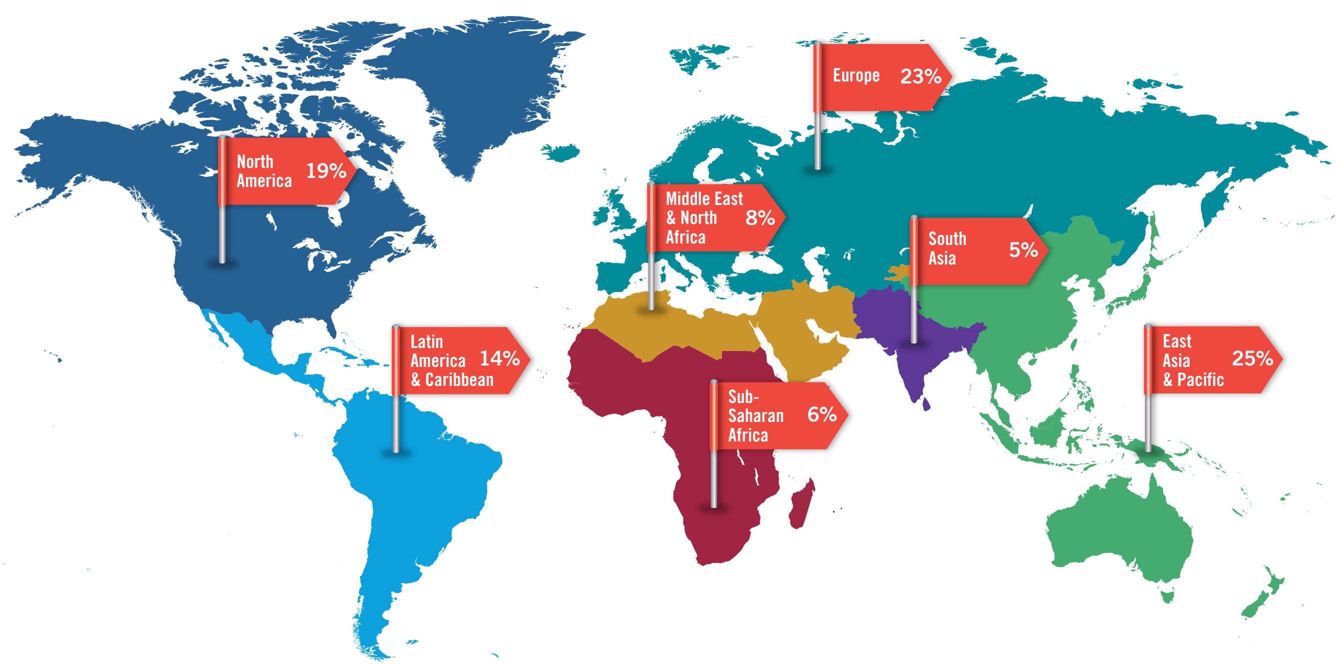
*Response rates vary per question.

The Global Internal Audit Common Body of Knowledge (CBOK) is the world's largest ongoing study of the internal audit profession, including studies of internal audit practitioners and their stakeholders. One of the key components of CBOK 2015 is the global practitioner survey, which provides a comprehensive look at the activities and characteristics of internal auditors worldwide. This project builds on two previous global surveys of internal audit practitioners conducted by The IIA Research Foundation in 2006 (9,366 responses) and 2010 (13,582 responses).

Reports will be released on a monthly basis through 2016 and can be downloaded free of charge thanks to the generous contributions and support from individuals, professional organizations, IIA chapters, and IIA institutes. More than 25 reports are planned in three formats: 1) core reports, which discuss broad topics, 2) closer looks, which dive deeper into key issues, and 3) fast facts, which focus on a specific region or idea. These reports will explore different aspects of eight knowledge tracks, including technology, risk, talent, and others.

Visit the CBOK Resource Exchange at www.theiia.org/goto/CBOK to download the latest reports as they become available.

CBOK 2015 Practitioner Survey: Participation from Global Regions



Note: Global regions are based on World Bank categories. For Europe, fewer than 1% of respondents were from Central Asia. Survey responses were collected from February 2, 2015, to April 1, 2015. The online survey link was distributed via institute email lists, IIA websites, newsletters, and social media. Partially completed surveys were included in analysis as long as the demographic questions were fully completed. In CBOK 2015 reports, specific questions are referenced as Q1, Q2, and so on. A complete list of survey questions can be downloaded from the CBOK Resource Exchange.

CBOK Knowledge Tracks

Future

Global Perspective

Governance

Management

Risk

Standards & Certifications

Talent

Technology

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Executive Summary

Internal auditors often face challenges to their judgment and to their core ethical values. How they handle those challenges determines the value of the profession. This report provides an overview of results from the 2015 Global Internal Audit Common Body of Knowledge (CBOK) Practitioner Survey regarding ethics in internal auditing. It also provides a framework that can be used to analyze internal audit professional ethics and related pressures.

While all internal auditors are likely to face ethical pressures at some point during their careers, the CBOK practitioner survey data indicates that there are distinct differences in pressures on internal auditors in various regions across the globe. There are also differences in the strength of support for the function when internal auditors face ethical dilemmas.

Both the strength of ethical codes and internal audit responsibilities related to those codes have increased in the five years since the last CBOK survey was conducted, but the 2015 survey demonstrates that there are many ways in which the ethical environment can be improved. Too many organizations, especially in the public sector, do not have organizational codes of conduct or codes of ethics, and many internal auditors receive little or no training regarding The IIA's Code of Ethics. Relatively few ethics audits are taking place and the data suggests that it may be difficult to perform an audit of the ethical environment if an organization does not have a code of ethics.

In an ideal environment, internal auditors should always be able to present findings without the threat of personal recrimination. Unfortunately, internal auditors do not always operate in such environments. Internal auditors who resist pressure to change their findings are at times subjected to negative consequences such as pay cuts, involuntary transfers to other positions, or even termination of employment.

The internal audit profession could not exist without a strong foundation based on a commitment to ethical conduct. The framework provided by this report demonstrates a clear need for all internal auditors to adopt The IIA's Code of Ethics to help guide performance when they face ethical pressures.

Introduction

"No matter how well trained, every internal auditor must deal with challenges to their judgment and to their core ethical values. How they handle those pressures determines the value of the profession."

The internal audit profession could not exist without a strong foundation based on a commitment to ethical conduct. The IIA's Code of Ethics (see **figure 1**) demonstrates an ethical code built on four fundamental pillars: integrity, objectivity, confidentiality, and competency (see **exhibit 1**). The elements of the IIA's Code of Ethics lead to exemplary behavior by internal audit professionals.

Exhibit 1 Major Principles of The IIA's Code of Ethics

Why these four elements? Internal auditors utilize these pillars of strength:

1. To build the trust and confidence of users of internal audit reports, including those involved in governance
2. To guide internal auditors when they may face various pressures that might cloud their judgment
3. To prevent internal auditors from venturing into activities that could impair that trust
4. To ensure open communication and analysis of audit findings

> ***Insight: Guardians of Integrity***
>
> "Organizational integrity will never rise above the integrity of the people who create, administer, and monitor the internal control system."
>
> *—Michael Brozzetti, Principal Boundless LLC, Internal Audit Advisory Firm*

Pressure on Internal Audit Performance

The profession of internal auditing is based on the concept of adding value. The importance of adding value is reflected throughout The IIA's International Professional Practices Framework (IPPF), which describes the mission of internal auditing: "To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight."

Adding value is so fundamental to internal auditing that the concept is included within The IIA's official Definition of Internal Auditing:

> *"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."*[*]

[*] https://na.theiia.org/standards-guidance/mandatory-guidance/Pages/Definition-of-Internal-Auditing.aspx

Clearly, an efficient and effective internal audit function is crucial for enhancing and protecting organizational value. But despite the importance of having an independent internal audit function, internal auditors often face pressure to change or omit certain audit findings. A recent survey generated responses from 500 chief audit executives (CAEs) and found that 54% of the participating CAEs had been asked on at least one occasion to suppress an important audit finding. *The Politics of Internal Auditing* notes that 49% of surveyed internal auditors were asked at least once to not audit high-risk areas that had been included in the internal audit plan. In addition, two focus groups were conducted, yielding similar results.*

The 2015 CBOK practitioner survey revealed that many internal auditors had received little or no training regarding the *International Standards for the Professional Practice of Internal Auditing* (*Standards*) or even The IIA's Code of Ethics. In many organizations, The IIA's Code of Ethics was considered secondary to the organization's code of conduct. Perhaps that is not a bad thing. For example, when an organization has excellent governance, a strong culture and code of conduct, and a supportive board and/or audit committee, then the organization's code of conduct may be sufficient for ethical guidance. This is especially true when the audit function has been granted full access and can examine high-risk areas to enhance and protect organizational value. In almost all situations, The IIA's Code of Ethics and an organization's code of conduct can work together to enhance organizational excellence.

Existing research recognizes another element that affects ethical behavior: the organization's culture. The culture sets the tone for the organization with unwritten rules about acceptable behavior; however, it is important to understand that an organization's culture can change quickly. Many organizations that were once thought of as highly ethical changed rapidly and dramatically when there was strong pressure to create short-term earnings.**

* Patricia K. Miller and Larry E. Rittenberg, *The Politics of Internal Auditing*, The IIA Research Foundation, Altamonte Springs, FL, 2015

** Ibid.

Global Issues Related to Ethics and Pressure

The CBOK survey examined a number of issues related to ethics and pressure on a global basis. The survey questions surrounded:

Administrative Reporting and Organizational Structure

- Primary administrative reporting lines
- Primary functional reporting lines
- Ultimate responsibility for the performance evaluation of internal auditing
- Decision makers for the use of internal audit services
- Final decision makers on the appointment of the CAE

Organizational Pressure

- Pressure to suppress or significantly modify an audit finding
- Source of the pressure to suppress or significantly modify an audit finding

Ethical Frameworks for Internal Audit Decision Making, where appropriate

- Organization's code of conduct or code of ethics
- The IIA's Code of Ethics

Demographics of Individuals Responding

- Age of respondent
- Position in the internal audit function of respondent

The comprehensiveness of the questions and the diverse backgrounds of the individuals responding to the survey provide (a) a state of the profession on a global basis, and (b) identification of potential areas for improvement. In order to put the data in context, it is important to develop a framework for analysis. This report analyzes the 2015 CBOK practitioner survey data within a framework and concludes with the author's observations about what the profession can do to protect and enhance ethical behavior.

Figure 1 **The IIA Code of Ethics**

CODE of ETHICS

PRINCIPLES

Internal auditors are expected to apply and uphold the following principles:

- ***Integrity***

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

- ***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.

- ***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.

- ***Competency***

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

RULES OF CONDUCT

1. INTEGRITY
Internal auditors:

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.

2. OBJECTIVITY
Internal auditors:

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.

3. CONFIDENTIALITY
Internal auditors:

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.

4. COMPETENCY
Internal auditors:

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.

Reference: The Institute of Internal Auditors Code of Ethics (2016).
https://na.theiia.org/standards-guidance/Public%20Documents/2010-06-16_10165_Code_of_Ethics.pdf

1 Ethics, Pressure, and Internal Audit: A Framework

1.1 Internal Audit Ethical Behavior

Before analyzing internal audit ethical behavior, we should start by defining "ethical behavior." One of the more comprehensive definitions is found in the *Business Dictionary:*

> "*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 rights.*"*

Exhibit 2 provides a framework that can be used to analyze internal audit professional ethics and related pressures. The framework starts with an ethical context (i.e., ethical behavior is related to society and what its citizens believe are "good values"). The focus of ethics is on moral judgment about such things as honesty, fairness, equality, dignity, diversity, and individual rights. These concepts are often embodied in organizational codes of conduct.

Professional codes of ethics are derived from broader ethical codes and are normally designed to ensure that a profession and its members secure their stakeholders' trust. Professional ethics is defined in the *Business Dictionary* as:

> "*Professionally accepted standards of personal and business behavior, values, and guiding principles. Professional ethics are often established by professional organizations to help guide members performing their job functions according to sound and consistent ethical principles.*"**

There can be significant differences between organizational codes of conduct and professional codes of ethics. In most cases, organizational codes of conduct describe how individuals should act within the organization and how they should deal with others outside of the organization. Such codes often discuss issues such as fair dealing, trust, confidentiality of information, respect in the workplace, and honesty. On the other hand, a professional code of ethics creates expectations regarding performance for every member of the profession. These expectations may go beyond organizational codes of conduct. Thus, we find that professional codes of ethics for medicine, law, external auditing, and internal auditing are each designed to recognize the special functions of these professions.

Every organization establishes its own unique culture and values. Often, those values are reflected in a code of conduct, but it is not sufficient merely to develop a code of conduct. The code of conduct must also be communicated effectively and processes must be in place to ensure adherence to the code. For example, Enron Corporation—a company that failed in the wake of widely publicized ethical lapses—had a code of conduct that emphasized:

- Respect
- Integrity
- Communication
- Excellence
- Confidentiality
- Serving the company

At Enron, employees were required to read the code of ethics and sign a statement that they would adhere to the code. Unfortunately, however, the existence of a

* http://www.businessdictionary.com/definition/ethical-behavior.html#ixzz48JBB9Mhw

** http://www.businessdictionary.com/definition/professional-ethics.html#ixzz48JCVZW4R comprehensive written code of ethics seemed to have less impact on ethical conduct at Enron than did the organization's leadership style and nonverbal communications. Similar comments could be made about the recent events at Wells Fargo in the U.S., where the corporate culture was at odds with their code of ethics.*

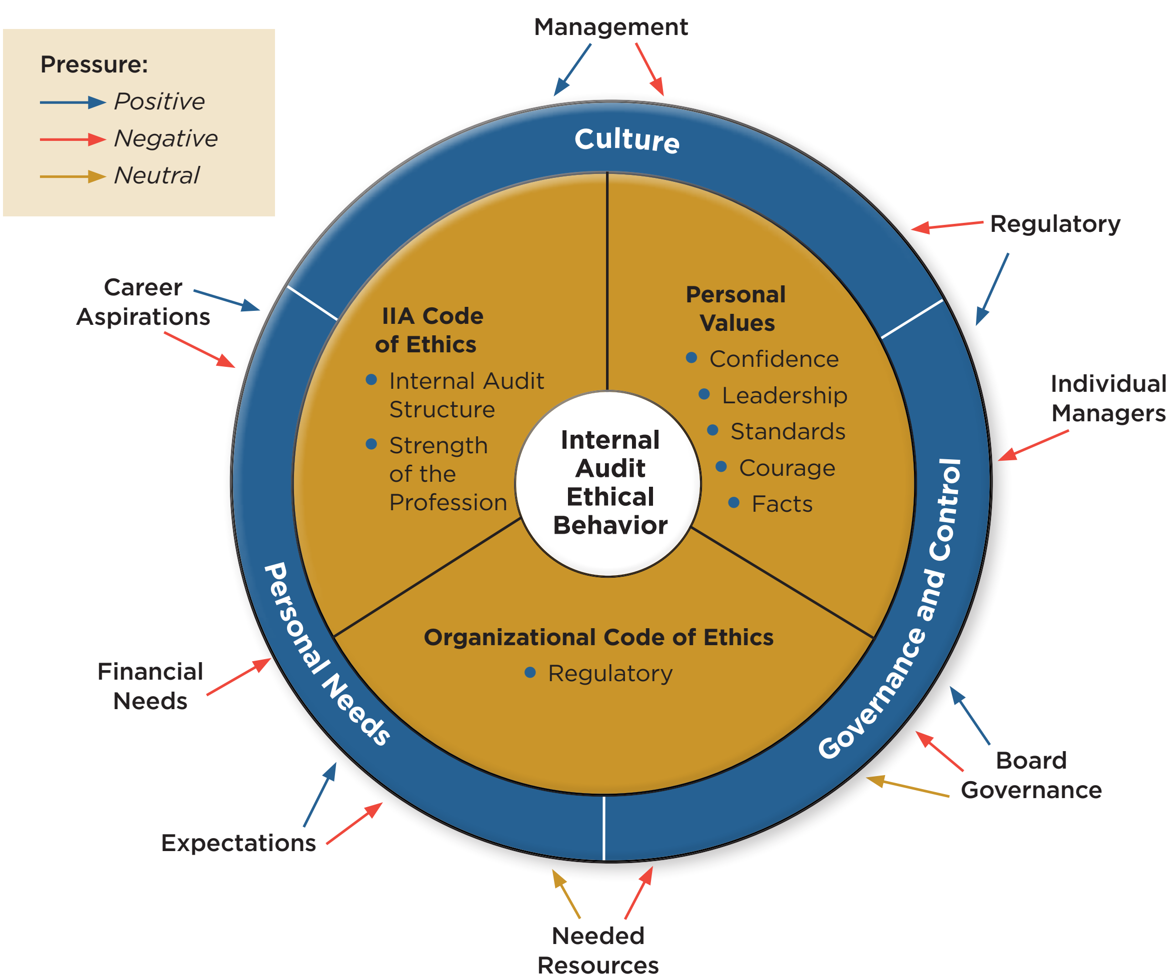
* Such communication can be either positive or negative. In the case of Enron, the communication was negative because it emphasized that "meeting and growing earnings" was the primary value of the organization. In other organizations, including some that the author is acutely aware of, the action taken in responding to ethical breaches was a very positive force that communicated zero tolerance for unethical behavior.

1.2 Stimulating Ethical Behavior: Sources of Ethical Values

Many factors can affect ethical decision making. As shown in the framework provided in **exhibit 2**, broad societal factors affect the outer ring, which is made up of personal needs, culture, and the governance and control components. In turn, these outer-ring components influence specific considerations affecting internal audit ethical decision making:

- Personal values
- Organizational codes of ethics
- The IIA Code of Ethics

Exhibit 2 **Ethics and Pressure: An Internal Audit Framework**



The inner ring of the framework is important, as the components are designed to encourage ethical behavior by internal auditors. Ideally, each of the three rings included in the framework should complement and reinforce the others. For example, personal values are essential in assuring ethical behavior, but some individuals (often those involved in fraud or other wrongdoing) might value economic gains over doing the right thing.

To mitigate differences in personal values, organizations develop codes of conduct that communicate the organization's basic values to employees, suppliers, customers, and other stakeholders. Oftentimes, these codes are written quite broadly and use terms such as "strive for excellence," "treat customers as we would like to be treated," or "avoid doing things that would not look good in the newspaper." Lack of clarity in such codes of conduct has often contributed to inappropriate behavior.

The IIA's Code of Ethics was developed to establish and build trust in internal auditing. This code is intended to protect both the internal audit function and the organization's stakeholders in situations where personal values and organizational codes may not be sufficient.

"A successful auditor embeds the principles of The IIA's Code of Ethics into their work. By following a code that represents integrity, objectivity, confidentiality, and competency, internal auditors increase value; conversely, an organization without the internal audit function committed to its professional ethics risks losing the drive of those who want to "do the right thing."

—Thomas O'Connor
Director of Internal Audit, Urban Outfitters

1.3 Key Outside Factors Affecting Ethical Conduct

The three factors in the outer ring of **exhibit 2** (personal needs, culture, and governance and control) demonstrate that some factors, which normally have a positive influence, might also create significant risks when they are misapplied. **Exhibit 3** identifies some of the positive influences, as well as some risks and negative behavior associated with the three factors.

Insight: Trusted Advisors

Miryam Pena, ethics and compliance officer for international companies located in South America, suggests that internal audit must work as a team, align with the goals of the organization, and be seen as a trusted advisor. She believes that The IIA's Code of Ethics is essential to reduce the risk in situations where "an internal auditor, due to pressures, might prefer to implement a friendly collaborative approach to negotiate or smooth the findings in order to be accepted as team player." Further, she believes that it is important for internal auditors to develop soft skills to help them implement the proper approach in cases where there might be pressures and resistance with the auditees.

Individuals attracted to the internal audit profession usually have high personal values and ethical standards. Similarly, many internal auditors are attracted to strong organizational cultures consistent with their own values. The organization's governance and control environment should support both the internal auditor's personal needs and values and the organizational culture.

"We now employ more than 250,000 people, and the chances of that number getting through the day without any bad behavior occurring is nil. But we can have a huge effect in minimizing such activities by jumping on anything immediately when there is the slightest odor of impropriety. Your attitude on such matters, expressed by behavior as well as words, will be the most important factor in how the culture of your business develops. Culture, more than rule books, determines how an organization behaves."

—Warren Buffett
2010 Annual Report, Berkshire Hathaway Inc.

Exhibit 3 Influence of Personal Needs, Culture, and Governance and Control

Personal Needs	
Positive Influence	**Risks and Negative Behavior**
• Desire for recognition as a professional	• Financial pressures
• Commitment to ethical behavior (high personal standards)	• Tendency to emulate actions viewed as "successful," whether ethical or not
• Career-oriented outlook, but not at the expense of personal respect	• Rationalization, (e.g., "Everyone else is doing this, so it must be okay.")
	• Tendency to "gloss over" potential findings if the internal auditor does not fully understand an issue

Culture	
Positive Influence	**Risks and Negative Behavior**
• Reinforces positive views	• The culture can change very quickly.
• Encourages "individual ownership" of results	• The culture may value "short-term results."
• Publicly recognizes positive actions, which reinforces "doing the right thing"	• The organization may use performance measures that inadvertently reward poor ethical behavior (e.g., bonuses or stock options that do not consider long-term ethical behavior).
• Enhances commitment of individuals to ethical behavior by being recognized as a socially responsible organization	• The culture may not be properly aligned with organizational strategy.

Governance and Control	
Positive Influence	**Risks and Negative Behavior**
• Reinforces the "tone at the top" and ethical commitment	• Weaknesses in the control environment are often pervasive.
• Has an internal audit mission that is grounded in concepts of risk management and governance and control	• An unwritten, but real risk appetite might be considered dangerous.

An organization's culture is different from its corporate governance and from its code of conduct. An article in the *Wall Street Journal* asks:

> *Is it more important to have rules to guide employees away from doing wrong, or is it better to instill a corporate culture where rules are less pronounced because everybody who works there knows they are expected to do what is right?*[*]

[*] Ben, DiPietro, "What Matters More: Focusing on Rules or Creating Ethical Culture?" *The Wall Street Journal*, March 15, 2016.

The crux of the argument is that codes of conduct are often written like rules. The argument proceeds with an assumption that when something is written as a rule, the natural inclination is to find a way to circumvent the rule or to interpret it in a fashion that suits the individual. In some ways, broad-based principles can be subject to the same weakness (e.g., be interpreted in a way that "rationalizes" inappropriate behavior). The conclusion:

> "*Values drive behaviors, and behaviors drive outcomes, so it's critical for leaders to not only have their fingers on the pulse of the culture in the organization, but to also know how to influence that culture," said Jean-Marc Levy, president of ethics and compliance solutions at LRN. "It's really about finding ways to influence and inspire workers to adhere to values and ethical culture."**

Culture is a collection of acceptable values among a group, and therefore it should be addressed in any evaluation of professional ethics. The importance of organizational culture is underscored by the proactive approach of The IIA in encouraging audits of organizational culture. The gap between organizational culture and written codes of conduct can often be large and should be considered by internal auditors.

Finally, the quality of corporate governance, particularly the control environment and related internal controls, can be, and should be, one of the major sources of support for strong ethical behavior throughout the organization. Internal auditors often face situations in which audit findings are not embraced by audit clients. Strong governance and codes of ethics can mitigate potential risks in such situations.

1.4 Pressure: Multiple Sources

The sources of pressure on individual internal auditors are diverse. In addition to pressure from senior management, operational management, or other employees, factors such as personal financial stress or career aspirations can influence stress levels. Many people often think of pressure as a negative thing; however, **exhibit 2** shows that pressure can be either positive or negative. For example, governance can be a strong positive pressure, as can career aspirations, support from top management, or regulatory guidance.

Negative pressure may manifest itself in many ways. *The Politics of Internal Auditing* reports more subtle forms of pressure, such as decreasing internal audit budgets, holding internal audit positions open and unfilled, the involuntary transfer of the CAE, and an ostracized CAE (and audit staff) by the organizational leaders.

* Ibid.

AUDITING CULTURAL VALUES

In a July 29, 2014 blog on auditing organizational culture, Richard Chambers, President and CEO of The IIA states, "Even once-unthinkable subjects like corporate culture are now subject to audit. This is as it should be. We can't deliver fully effective risk-based audit services if we ignore critical issues, such as a toxic corporate culture."

Chambers cites an IIA-UK report that suggests internal auditors need to:

- Go beyond a focus on processes and controls and undertake root-cause analysis to identify cultural weaknesses.
- Audit cultural indicators to determine the extent to which culture and values are at the heart of every business decision.
- Include indicators such as recruitment policies, training, performance management, and reward.
- Audit not just tone at the top, but tone throughout the organization.
- Trust our judgment—even if, at times, it means taking a subjective approach.*

* https://iaonline.theiia.org/auditing-the-organizational-culture

1.5 Framework Summary

The framework described illustrates the wide variety of risks associated with pressures that may affect internal audit ethical behavior—either positively or negatively—and the vital importance of a professional code of ethics. The framework also illustrates that a professional code of ethics is different from organizational codes of ethics. The 2015 CBOK practitioner survey addresses many of these issues.

2 CBOK: Source of Governance and Ethics Guidance

2.1 Reporting Responsibilities and Appointment of CAEs

Appropriate reporting lines can influence and encourage ethical behavior by internal auditors. CAEs often have dual reporting lines that are divided between administrative reporting and functional reporting. Internal audit administrative reporting generally focuses on the day-to-day and month-to-month activities of the internal audit function. Functional reporting focuses on the ultimate responsibility of the internal audit function. That ultimate responsibility includes the approval of the audit plan and the audit budget, and the responsibility of appointing and/or retaining the CAE.

As shown in **exhibit 4**, most internal audit functions report administratively to management, ranging from the chief executive officer (CEO) to the chief financial officer (CFO) to legal counsel. On the other hand, almost three-quarters of internal audit functions report functionally to the audit committee or board of directors.

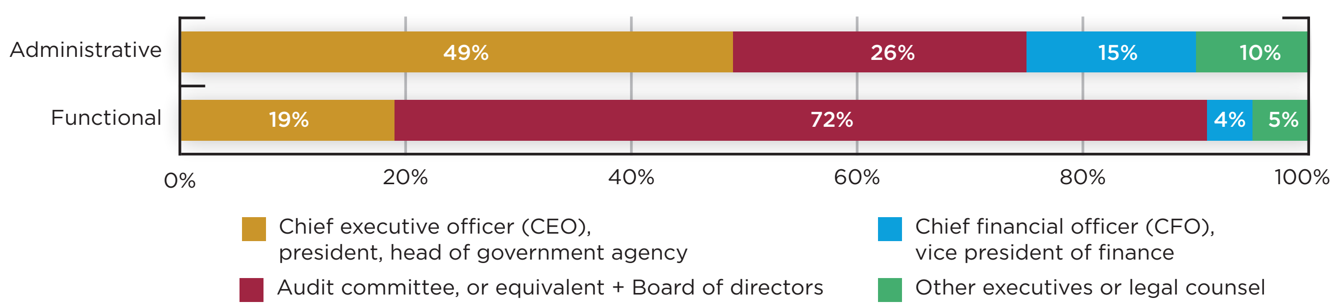
As indicated in **exhibit 5,** typical internal audit reporting lines tend to vary by region.

While 72% of CAEs reported functionally to an audit committee or board of directors, the response rates ranged from a low of 62% in East Asia & Pacific, to a high of 87% in Sub-Saharan Africa.

The Politics of Internal Auditing found that a key factor in mitigating the effects of management pressure was a strong relationship between the CAE and the chair of the audit committee. But that factor is fully effective only when the audit committee is independent, both in appearance and in action. *The Politics of Internal Auditing* also cited numerous situations in which the audit committee was not effective in mitigating pressures because: (a) the audit committee did not want to hear bad news, or (b) the audit committee, although independent on paper, was dominated by the chairperson and/or the CEO.

Closely related to oversight is the question of who should have the authority to appoint or remove the CAE. Most internal auditors report that their board or audit committee has the ultimate appointment and retention authority (see **exhibit 6**).

Exhibit 4 Internal Audit Reporting Lines



Note: What is the primary administrative reporting line for the CAE or equivalent in your organization? *n* = 2,608.

Insight: When the Going Gets Tough, Managers often turn to General Counsel

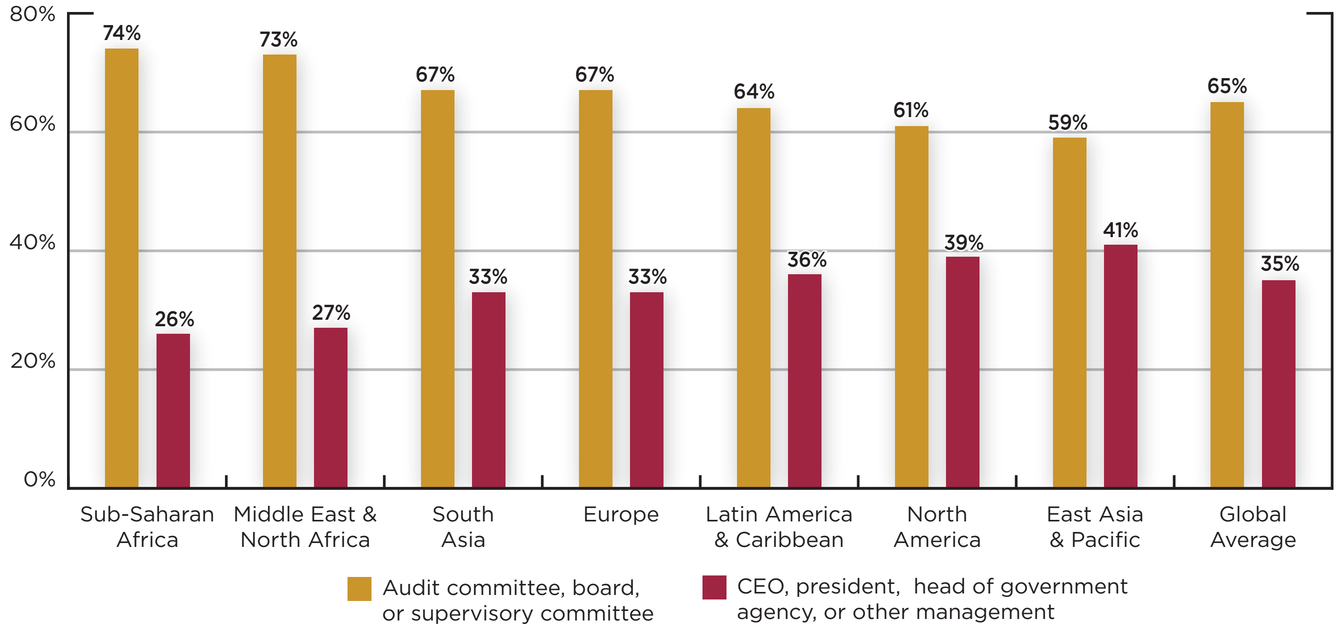
Steve Minder, CEO of YCN Group, a consulting company specializing in internal audit activities and reviews, observes that when situations are difficult, management often turns to general counsel to determine appropriate courses of action. Unfortunately, he states, the law profession merely provides training on how to eliminate or reduce the negative impact of these situations. Such an approach is often contrary to what an approach grounded in positive ethics would suggest doing. Most standards of ethical conduct promote transparency and openness in dealing with important issues.

Exhibit 5 Internal Audit Reporting Responsibilities (Regional Comparison)

	Sub-Saharan Africa		Middle East & North Africa		Latin America & Caribbean		Europe		South Asia		East Asia & Pacific		North America		Global	
Reporting Line	**Funct**	**Admin**	**Funct**	**Admin**	**Funct**	**Admin**	**Funct**	**Admin**	**Funct**	**Admin**	**Funct**	**Admin**	**Funct**	**Admin**	**Funct**	**Admin**
Chief executive officer (CEO), president, head of government agency	11%	75%	20%	61%	27%	54%	20%	45%	11%	39%	30%	53%	8%	33%	19%	49%
Audit committee, or equivalent + board of directors	87%	7%	75%	28%	63%	33%	71%	36%	79%	27%	62%	29%	80%	11%	72%	26%
Chief financial officer (CFO), vice president of finance	0%	11%	3%	5%	3%	7%	4%	11%	8%	23%	3%	6%	8%	36%	4%	15%
Other executives or legal counsel	2%	7%	2%	5%	6%	5%	6%	8%	2%	11%	5%	11%	4%	19%	5%	10%

Note: Q74: What is the primary functional reporting line for the CAE or equivalent in your organization? *n* = 2,599

Exhibit 6 **Who Appoints the CAE? (Regional Comparison)**



Note: Q75: Who makes the final decision for the appointment of the CAE or equivalent? (CAEs only) *n* = 2,380

The CBOK practitioner survey results show that the trend toward CAE appointment by an audit committee or board is strong and consistent, with only North America and East Asia & Pacific falling moderately below the average.

When looking at the appointment relationship by industry (see **exhibit 7**), the low rate for audit committee or board appointments by public sector (governmental units) is both surprising and concerning. Less than half of the public-sector organizations reported audit committee or board responsibility for the appointment of the CAE.

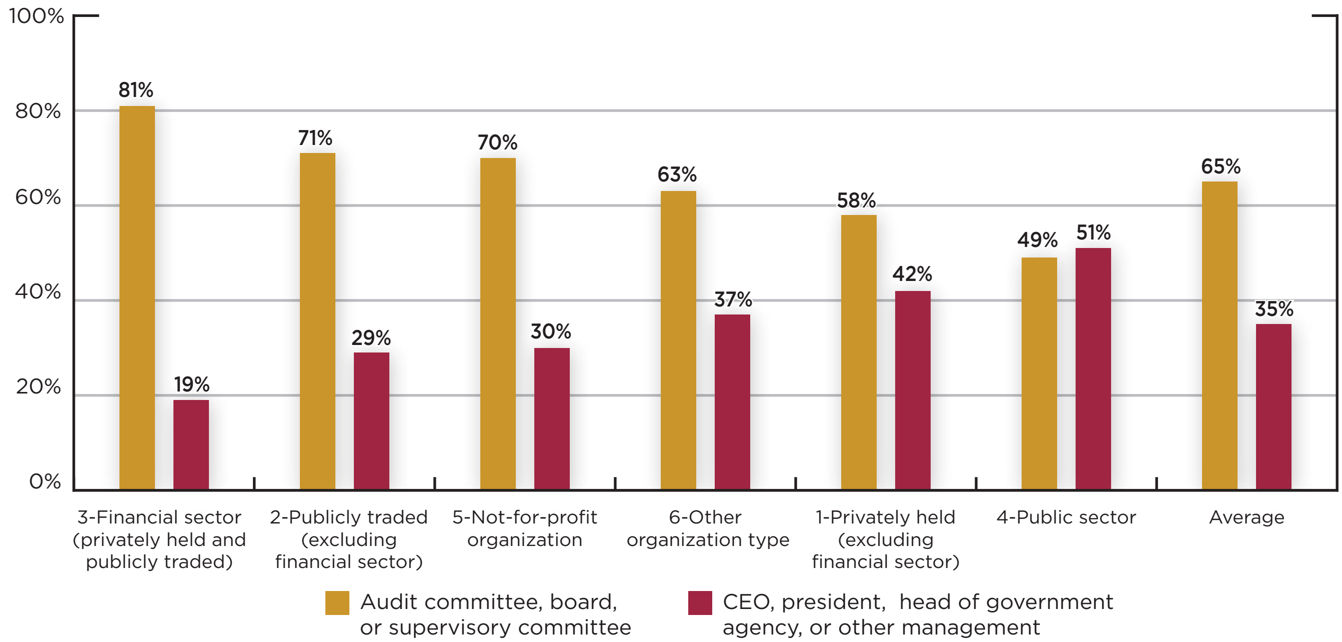
Public-sector organizations consume significant resources, and strong governance procedures are necessary to help assure that these resources are used efficiently and effectively. In public-sector organizations, there is often a need for an oversight body that is independent of the political process. Yet a recent CBOK report on audit committees noted that only 65% of public-sector entities had audit committees or equivalent governance bodies. Less than half (49%) of the public-sector entities had a CAE.*

The lack of a reporting line to an oversight group such as an audit committee, is disconcerting. In contrast, a majority of privately held companies have a CAE whose appointment was approved by an audit committee or board. It is this author's opinion that governance of our public-sector organizations needs substantial improvement, and that internal auditing and an independent review function, such as an audit committee, are needed.

Not surprisingly, the percentage of CAEs appointed by audit committees or boards increases as organizational size increases. At over 80% of the largest organizations participating in the CBOK survey, the CAE was appointed by an audit committee or equivalent governing body (see **exhibit 8**).

* Larry E. Rittenberg, *Interacting with Audit Committees: The Way Forward*: A Component of the CBOK Study (Altamonte Springs, FL: The IIA Research Foundation, 2016)

Exhibit 7 **Who Appoints the CAE? (Industry Comparison)**



Note: Q75: Who makes the final decision for the appointment of the CAE or equivalent? CAEs only. *n* = 2,409

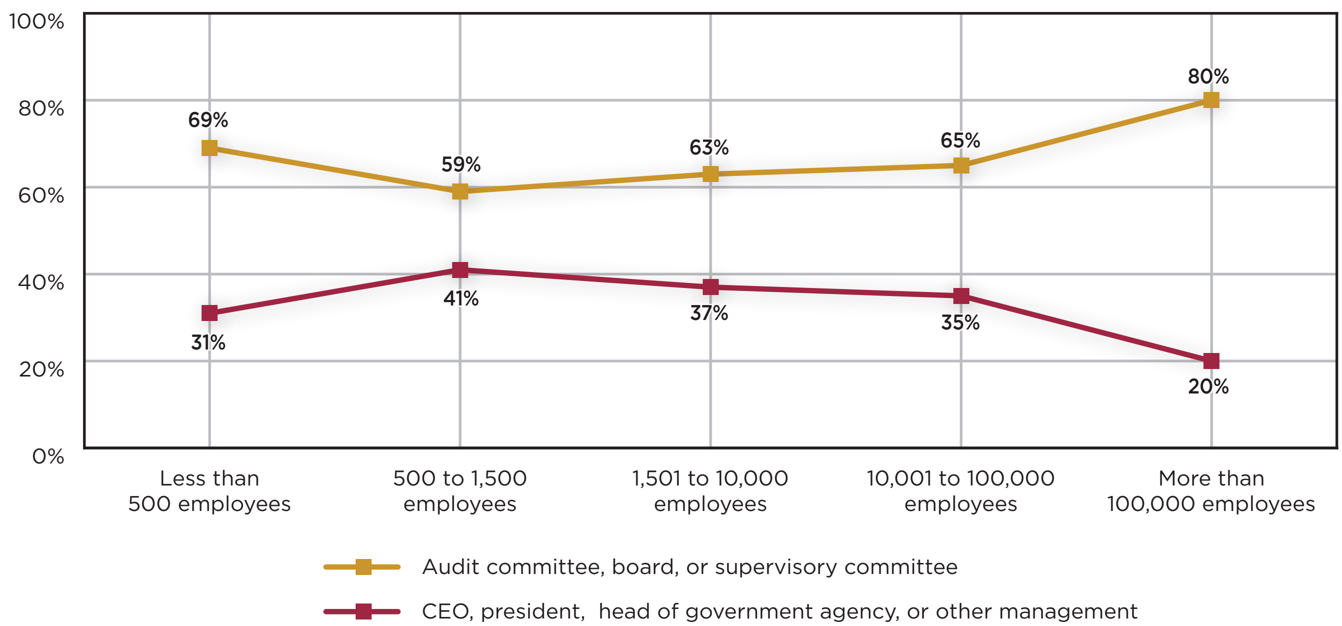
Insight: Critical Factors for the CAE

Richard Anderson, clinical professor at DePaul University and a former CAE makes the following observation: The really important issues, like the reporting lines, the expectations of the audit committee, and who appoints and reviews the CAE, that build and support an ethical culture, are topics that a prospective CAE should explore fully during any interview process for a CAE position. The absence of any of these critical factors are potential red flags and point to an environment that this not conducive to supporting a strong and effective CAE. Taking a CAE position, and then later finding out that you don't have some of these foundational components for the position can leave you susceptible to many of the pressures noted.

"I believe that the public-sector results, reflecting that 51% of CAE appointments are made by the CEO, president, head of government, or other management, are driven by the many public-sector audit departments that do not have an audit committee established. The majority of CAE appointments for these positions are either made by the agency head or political oversight group that the CAE reports to (e.g., appointed boards, mayors, and city councils)."

—John Wszelaki
Director, American Center for Government Auditing

Exhibit 8 **Who Appoints the CAE? (Organizational Size Comparison)**



Note: Q75: Who makes the final decision for the appointment of the CAE or equivalent? *n* = 2,409

While the focus is often on the appointment of the CAE, it is also important to understand who evaluates the performance of the CAE. **Exhibit 9** indicates that this responsibility is generally split evenly between management and the board. The big exception is in North America, where 61% of CAEs are formally evaluated by management. Often however, these evaluations are reviewed by an audit committee. Among more developed economies, such as Europe, a higher percentage of CAE performance evaluations are made by the audit committee, board, or supervisory committee. It would appear that organizations in areas of the world where organizations typically have active supervisory committees, often rely on those committees to evaluate internal audit performance.

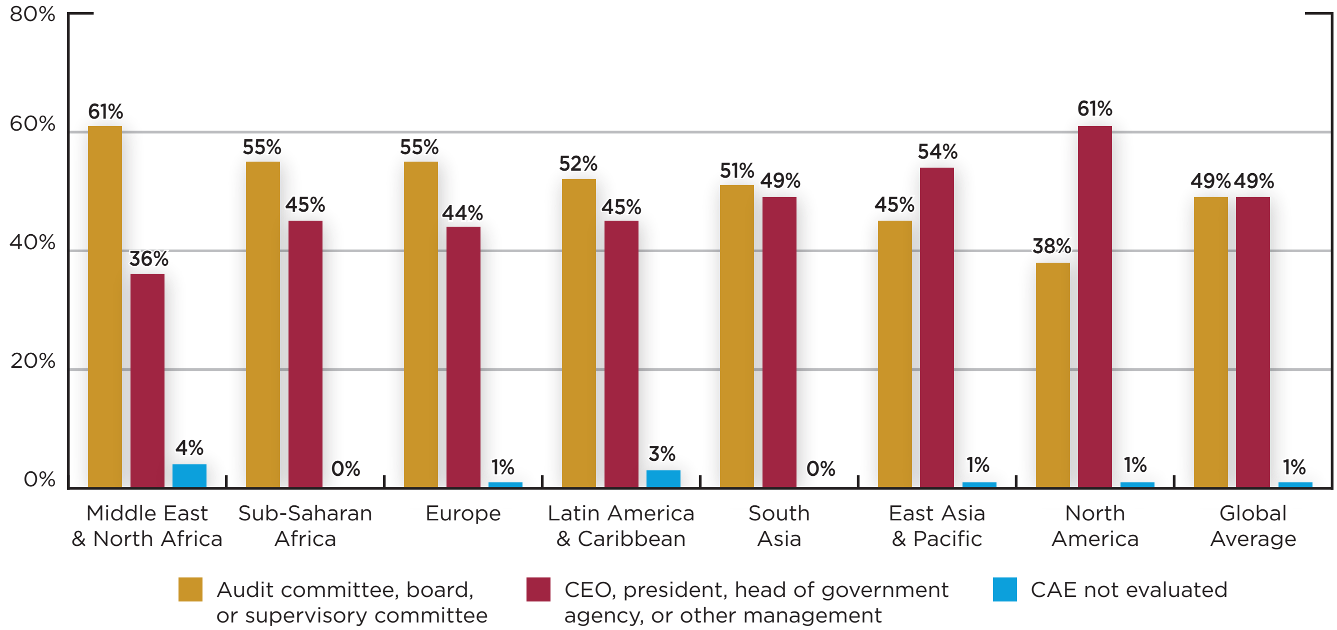
Insight: Serving Two Masters

Internal audit serves two masters—management and the board. Most of the time, the objectives of the two masters are the same, but when the board needs an impartial view of management performance, or where internal audit needs assurance that their findings will not be suppressed, it becomes vitally important that the audit committee or the board has the final say on the appointment or removal of a CAE.

Insight: Performing the Evaluation

Simon Nyazenga, group internal audit executive at Metallon Gold Zimbabwe (Pvt) Ltd, Zimbabwe, points out that in his experience, management most often does the performance evaluation of the CAE and reports that evaluation to the audit committee. The audit committee usually accepts the review, or they may decide to evaluate the CAE further. Thus, while the audit committee accepts or rejects management's review, the process is different from a full, independent evaluation by the audit committee.

Exhibit 9 **Who Evaluates the CAE? (Regional Comparison)**



Note: Q76: Who is ultimately responsible for the performance evaluation of the CAE or head of internal audit at your organization? *n* = 2,387

2.2 Codes of Ethics and Audit Committee Charters

The 2015 CBOK practitioner survey examined whether or not each participant's organization had a code of ethics and an internal audit charter. As shown in **exhibit 10**, most survey participants in every region reported that their organizations had both an organizational code of conduct or code of ethics and an internal audit charter.

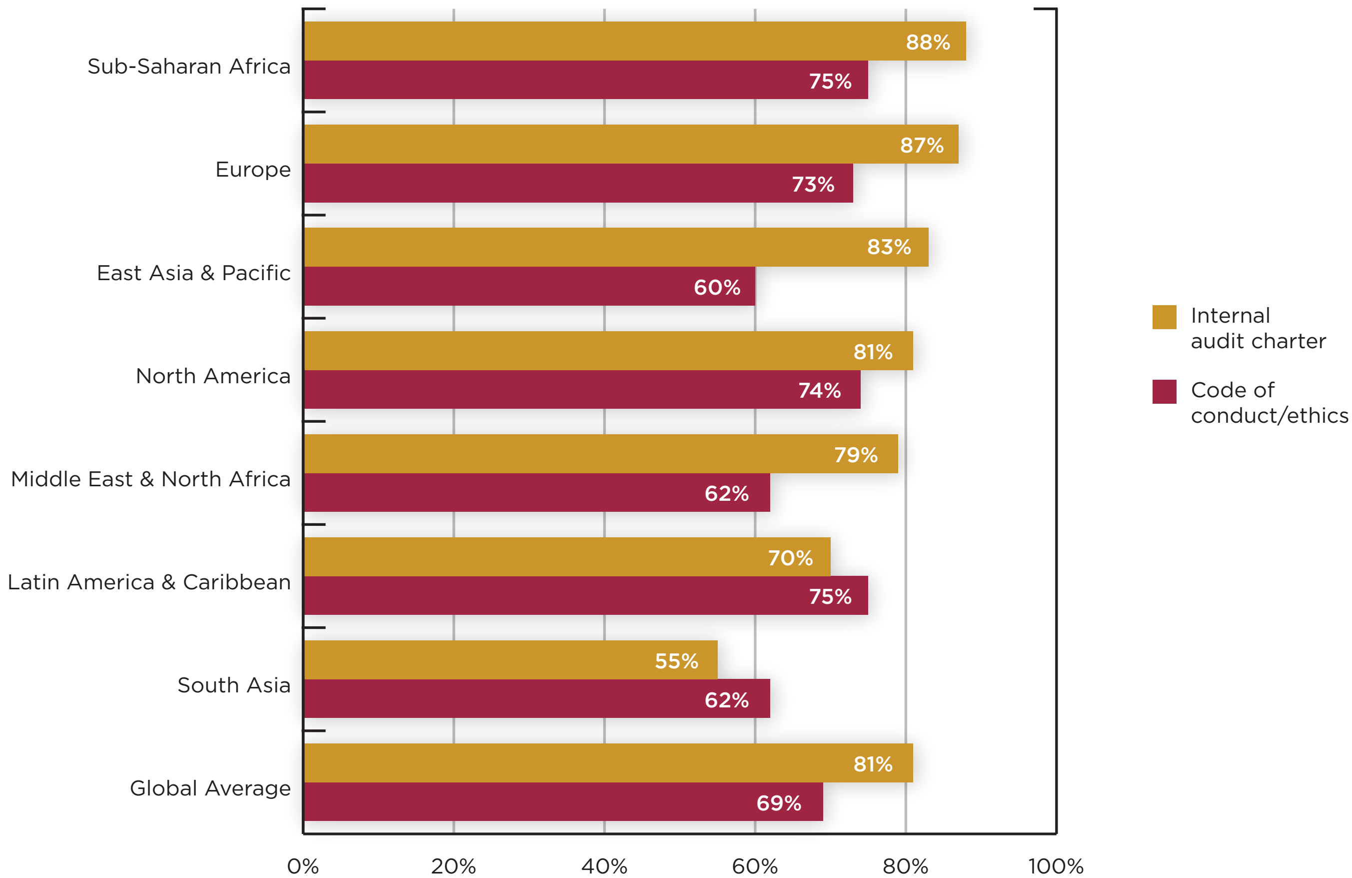
About 69% of survey participates report that their organizations have a code of ethics. The lowest percentage of participants reporting that their organizations do not have any code was in the East Asia & Pacific region (60%).

According to the survey, the global average for the existence of an internal audit charter was 81%. While this is good news, there are still areas of disappointment. For example, only 55% of survey participants in the South Asia region reported having an internal audit charter. In the Latin America & Caribbean region, 70% reported having a charter.

Insight: Ethical Environment in Asia and South Asia

Stanley Chang, former managing partner for China Advisory Services, former global leader for Business Risk Services, and current professor at National Taiwan University, has spent the last two decades building internal audit practices in China. He believes that Asian organizations tend not to distinguish themselves from others in terms of cultural or behavioral matters—that is, general ethics or moral beliefs are more of a macro matter, which affects people across society. Instead, more emphasis is placed on building organizational culture with the belief that ethics is homogenous across the country. Experience, however, shows that the presumed homogeneity in ethical climates may need to be reexamined as organizations compete in global markets.

Exhibit 10 Existence of Code of Conduct/Ethics and Internal Audit Charter



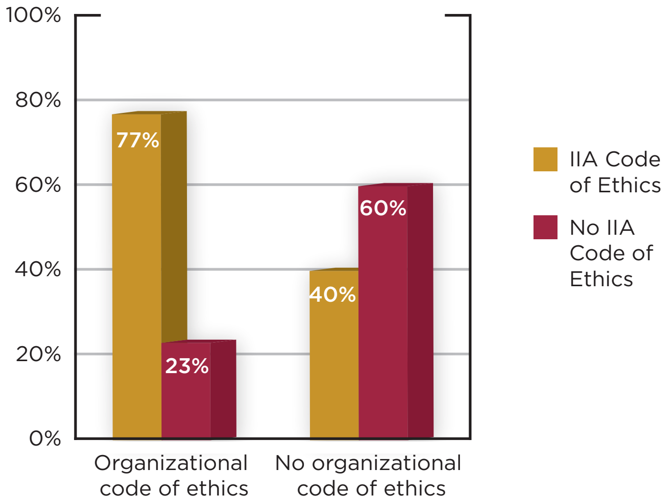
Note: Q29: Which of the following internal audit policies or documents exist in your organization? (Choose all that apply). In what region are you based or primarily work? *n* = 13,032.

An internal audit charter usually describes, among other things, access to audit areas, the structure of the internal audit function, and the scope of work to be performed. Unless the charter explicitly mentions conformance to The IIA's *Standards* or Code of Ethics, the internal audit function might not operate in accordance with generally accepted professional practices.

The analysis of organizations revealed little difference between organization types regarding the existence of a code of ethics or code of conduct. Again, the outlier was governmental organizations, where 31% of survey participants reported that they did not have either document.

The 2015 CBOK practitioner survey further examined the relationship between organizational codes of ethics and internal audit codes of ethics. The data demonstrates that there is a relationship between a strong organizational culture and support for The IIA's Code of Ethics. As indicated in **exhibit 11**, 77% of organizations that had a code of ethics also supported The IIA's Code of Ethics. Among organizations that did not have a code of ethics, only 40% supported The IIA's Code of Ethics. In other words, when the organization endorses ethical behavior through its own code of ethics, then it is more likely that the internal audit function will also adhere to The IIA's Code of Ethics.

Exhibit 11 **Relationship between Organizational Code of Ethics and Support for Internal Audit Code of Ethics**



Note: Q71: Which organizational governance documents exist in your organization? (Choose all that apply). *n* = 2,710.

> "Simply put, the best approach to an ethics audit is to evaluate how an organization turns their words into actions. An ethics audit should determine whether these corporate values are truly reflected in business practices and whether the right systems are in place to promote these values as well as detect and take corrective action when the erosion of value is discovered."
>
> *—Michael Brozzetti*
> *Principal, Boundless LLC,*
> *Internal Audit Advisory Services*

2.3 Audits of the Ethical Environment

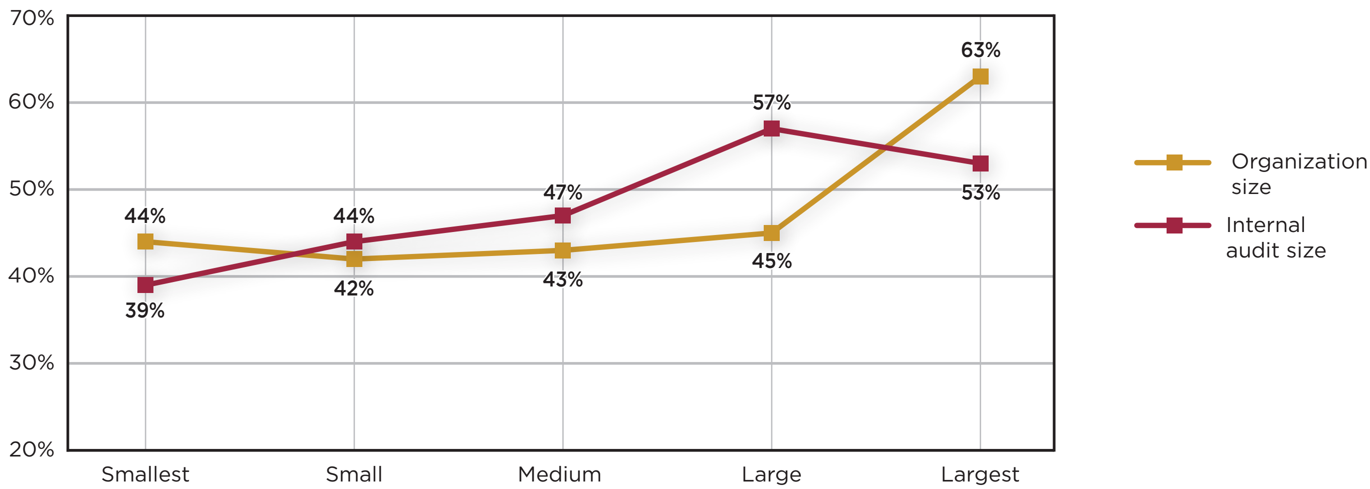
The CBOK survey examined whether or not internal auditors were performing audits of the ethical environment. The data shows that few of these audits are taking place. The data also indicates that it may be difficult to perform an ethics audit if an organization does not have a code of ethics.

When asked whether the internal audit function conducted an ethics audit, responses were categorized as *extensive, moderate, minimal,* or *none*. Very few respondents chose the extensive category, and only 20% of those surveyed responded to the question. Thus, the results presented most likely overstate the extent to which audits of ethics are taking place. The responses, grouped by both organizational size and internal audit function size, are shown in **exhibit 12**.

The data is consistent with expectations: The larger the organization and the larger the internal audit department, the more likely it is that audits of an organization's ethical climate are performed. Often, larger organizations have government contracts that require periodic reviews of corporate ethics. Other possible explanations for the relatively low numbers of ethics audits include:

- Ethics audits are assigned to a compliance group.
- The organization does not have a code of ethics.
- The control environment is weak.
- The internal audit activity has not built the skill set to perform such audits.

Exhibit 12 **Audits of Organizational Ethics**



Note: Q72: What is the extent of audit activity in your organization? *n* = 2,465.

3 Pressure to Change or Suppress Audit Findings

The 2015 CBOK practitioner survey asked three questions related to pressure to change or suppress audit findings:

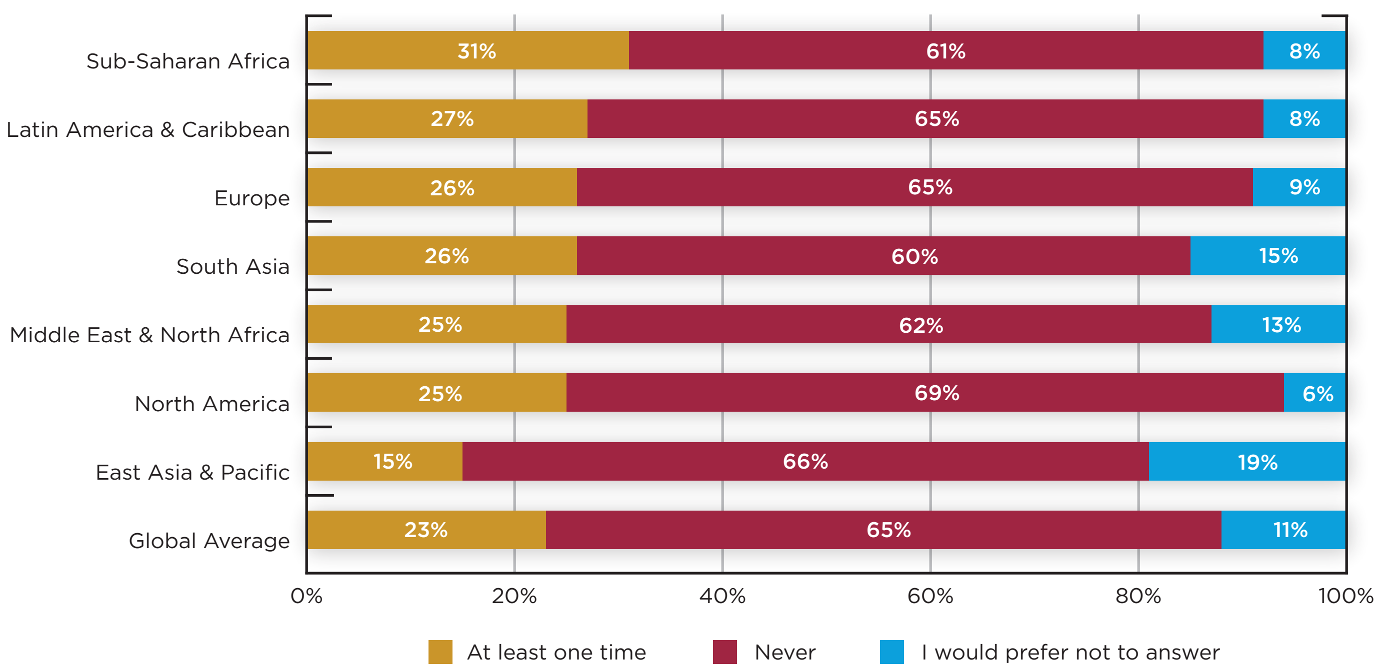
1. Have you experienced a situation where you were directed to suppress or significantly modify a valid internal audit finding or report?
2. Would you say that you have been directed to suppress or significantly modify a valid internal auditing finding or report on a regular basis (at least once a year)?
3. What was the source of the pressure when you were directed to suppress or significantly modify a valid internal audit finding or report?

The questions were asked of all participants, including staff auditors, managers, and CAEs. A large percentage of participants answered "yes" to the first two questions. The third question, regarding the source of the pressure, returned some unexpected responses.

3.1 Pressure to suppress or modify an audit finding

The Politics of Internal Auditing previously reported that over 50% of surveyed internal auditors have been asked to suppress or modify important audit findings. The results of this survey corroborate that report. Across all geographical areas, there is significant pressure put on internal auditors to change or suppress audit findings (see **exhibit 13**).

Exhibit 13 Pressure to Change Audit Findings



Note: Q77: During your internal audit career, have you experienced a situation where you were directed to suppress or significantly modify a valid internal audit finding or report? *n* = 10,055.

In general, the responses are consistent across regions, with a global average of 23%; however, a large number of participants responded that they "preferred not to answer." The combination of individuals reporting pressure to change findings, plus those preferring not to answer the question totals 34%, or just a little over one-third of the participants.

The results from the East Asia & Pacific region are particularly interesting. Although only 15% said that they had been pressured to suppress or change important audit findings at least once, another 19% indicated that they preferred not to answer, for a total of 34%—the same average that was reported for other locations. One interpretation is that when participants stated that they preferred not to answer, that response often may have indicated that pressure existed *not to respond*, either from an internal or external source.

Because the largest "prefer not to answer" percentage was in the East Asia & Pacific region, additional analysis was performed, as shown in **exhibit 14**. Interestingly, auditors in China (including Taiwan and Hong Kong) had by far the largest percentage of auditors preferring not to answer (26%), with only 9% indicating pressure to change findings.

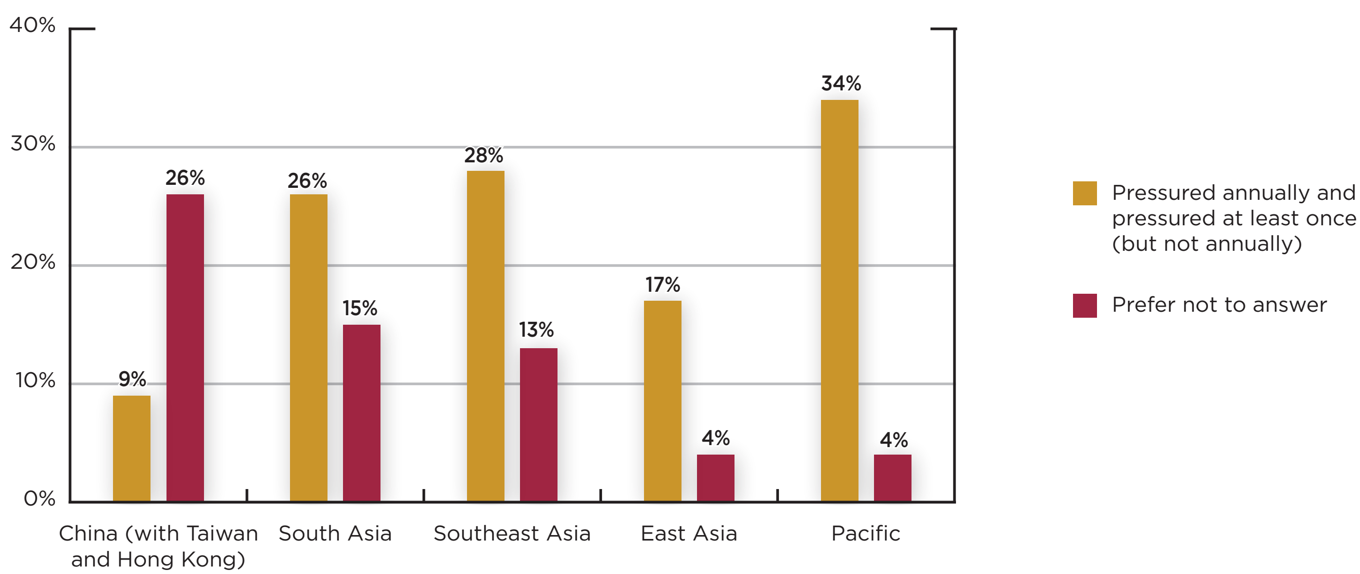
3.2 How Frequently is Pressure Exerted?

A large percentage of respondents of the 2015 CBOK practitioner survey said that they felt pressure to change audit findings on a regular basis. The frequency of pressure is indicated in **exhibit 15**.

The "pressure to change" data yielded interesting results when partitioned by position. CAEs were more willing to answer the question than were other internal audit professionals, and unsurprisingly, they indicated that they were under more pressure than other internal auditors. On the other hand, the pressure felt by staff auditors (20%) combined with those who preferred not to answer (14%) resulted in a total "pressure score" of 34%—a level that is the same as the average for CAEs, and that is fairly consistent with the pressure scores for all other internal auditors.

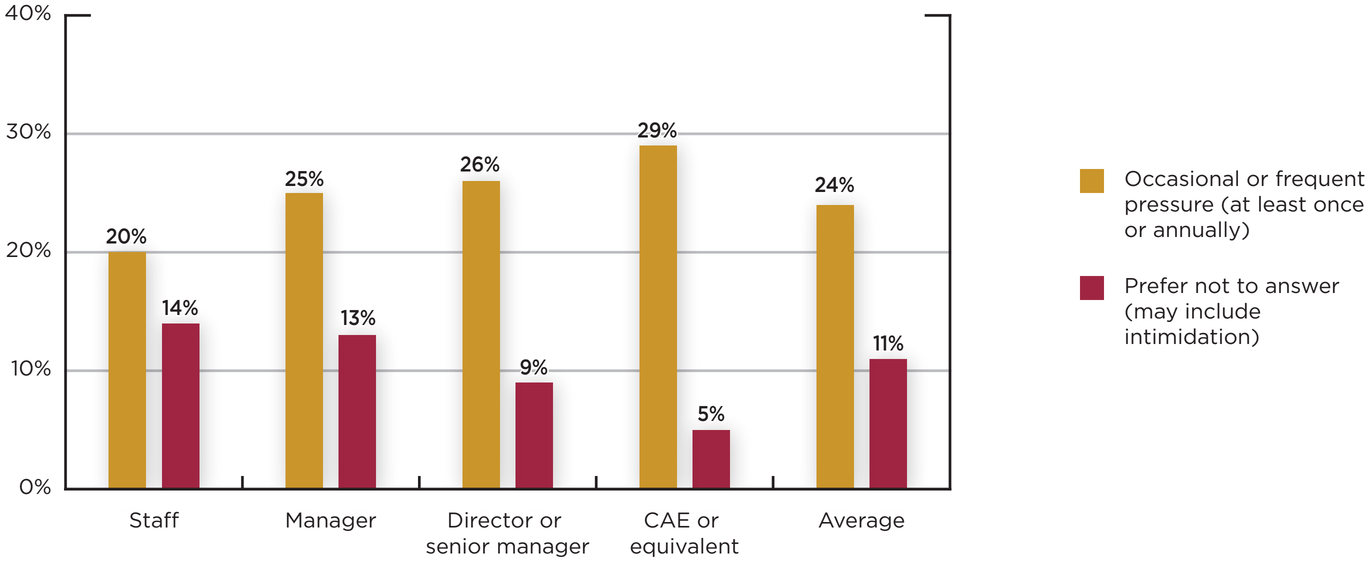
As shown in **exhibit 16**, there were no significant differences in response by gender, especially when combining "pressure" responses with "prefer not to answer" responses. On average, female internal auditors indicated that they

Exhibit 14 Pressure to Change Audit Findings (Asian Participants)



Note: Q77: During your internal audit career, have you experienced a situation where you were directed to suppress or significantly modify a valid internal audit finding or report? *n* = 1,341.

Exhibit 15 Pressure to Change Audit Findings – All Respondents



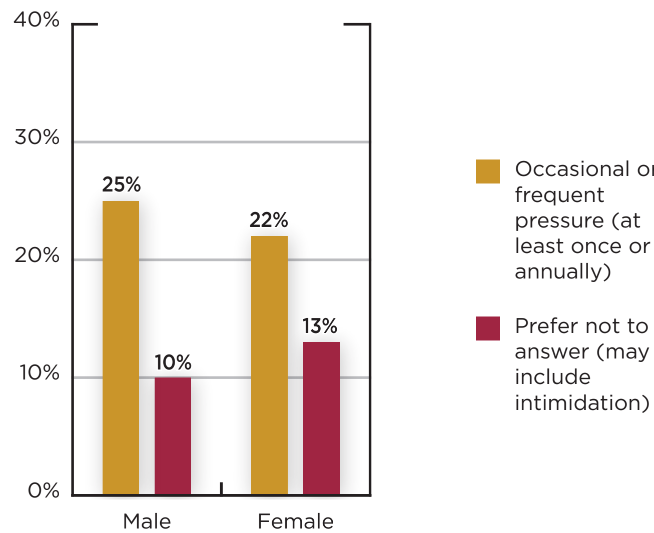
Note: Q77: During your internal audit career, have you experienced a situation where you were directed to suppress or significantly modify a valid internal audit finding or report? Coupled with Q81: What is your position as an internal auditor? *n* = 10,823.

experienced slightly less pressure than their male counterparts, but women were more likely than men to indicate that they preferred not to answer the question.

The data indicates that as internal auditors' ages increase, there is much less perceived pressure to change audit findings. It is possible that part of the difference results from a correlation between age and rank (see **exhibit 17**).

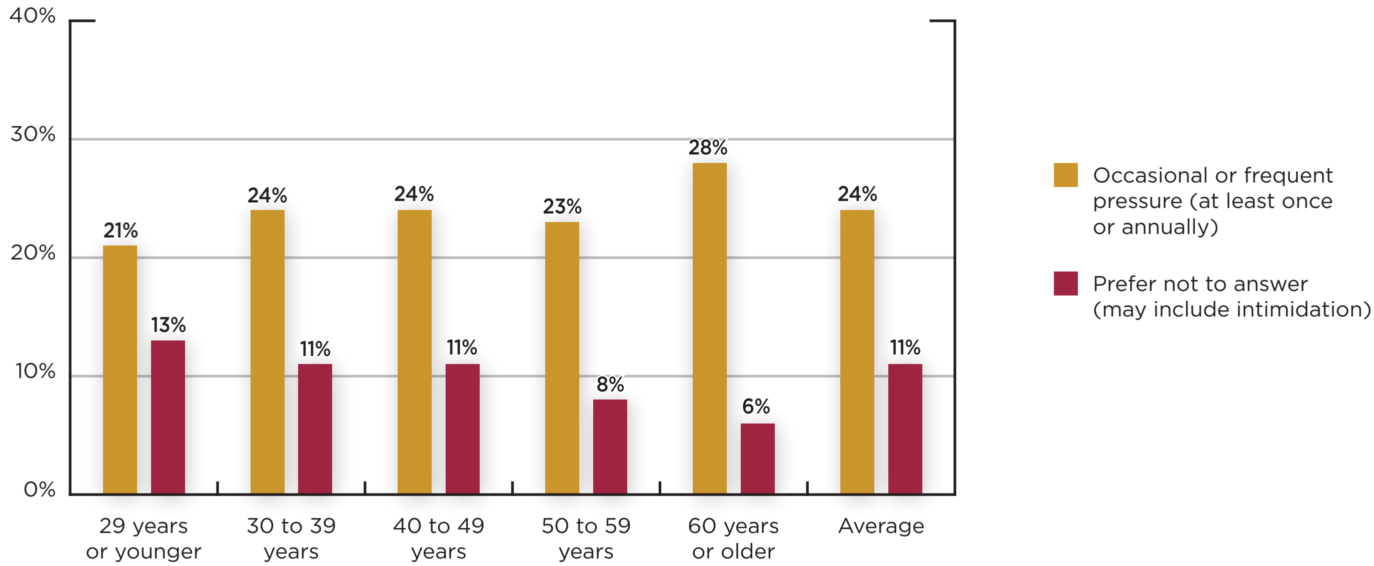
The CBOK survey also examined whether holding professional certifications, such as Certified Internal Auditor (CIA), made a difference in the perceived pressure exerted on internal auditors to change findings. As shown in **exhibit 18**, there was a significant correlation between certification rates and perceived pressure. Approximately 23% of those certified were pressured into changing audit findings, and only 5% were hesitant to answer (an overall pressure rate of 28%). Among those not certified, 28% indicated that they were pressured to change audit findings, and an additional 7% were hesitant to answer (an overall pressure rate of 35%).

Exhibit 16 Pressure to Change Audit Findings (Gender Comparison)



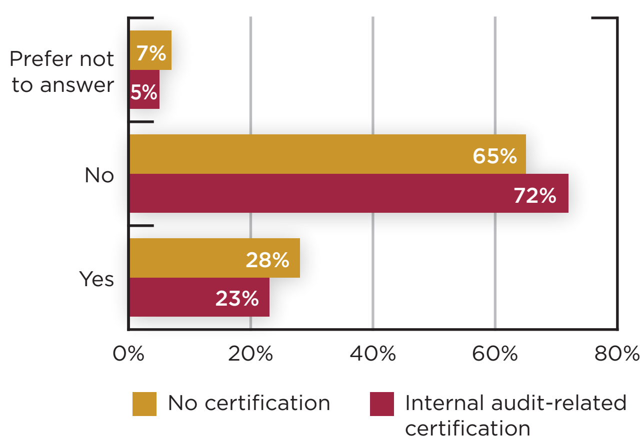
Note: Q77: During your internal audit career, have you experienced a situation where you were directed to suppress or significantly modify a valid internal audit finding or report? Coupled with Q4: What is your gender? *n* = 10,935.

Exhibit 17 **Pressure to Change Audit Findings (Age Comparison)**



Note: Q77: During your internal audit career, have you experienced a situation where you were directed to suppress or significantly modify a valid internal audit finding or report? Coupled with Q3: What is your age? *n* = 9,809.

Exhibit 18 **Professional Certification and Pressure to Change Audit Findings**

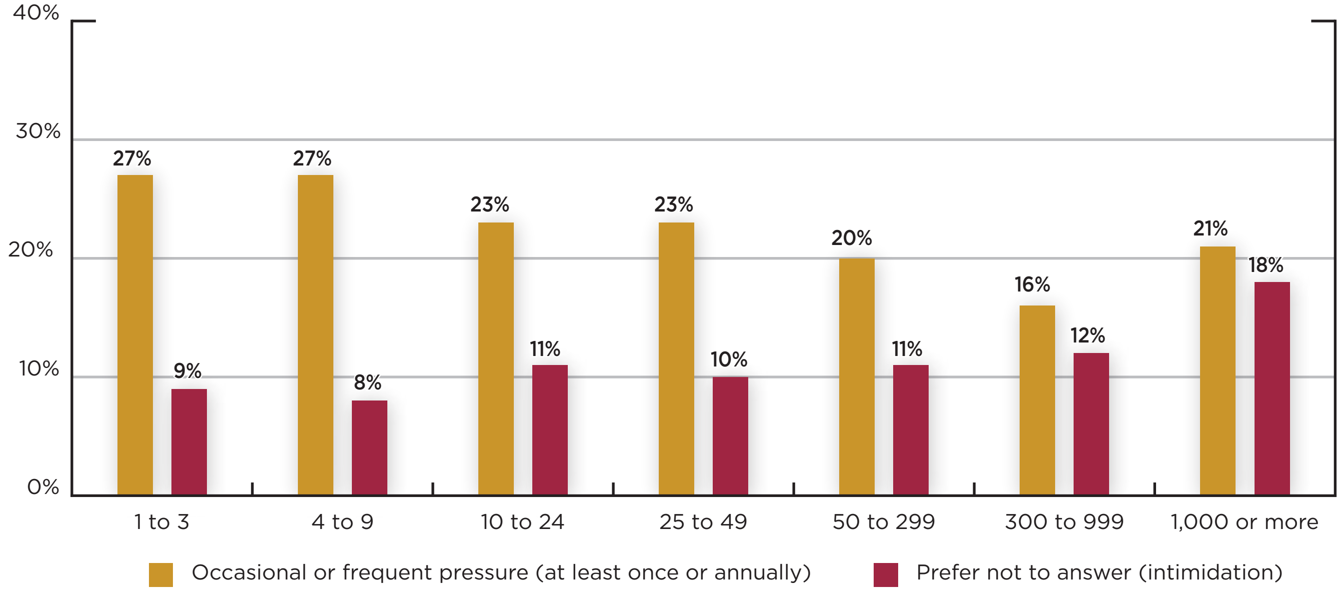


Note: Q104: Would you say that you have been directed to suppress or significantly modify a valid internal audit finding or report on a regular basis (at least once a year)? *n* = 1,175.

Exhibit 19 indicates that perceived pressure levels are related to the size of the internal audit function. The larger (and likely more mature) the internal audit function, the lower the amount of pressure is to change or suppress findings. Here again, however, as the reported pressure goes down, the number of "prefer not to answer" responses go up.

The pervasiveness of pressure suggests, in this author's view, that there is a need to improve two related factors: (1) governance and overall support for internal auditing, and (2) a mindset of always improving the quality and value of internal audit work. With that said, it is also important to recognize that pressure will never go away. It may exist because of legitimate disagreements about audit findings, or it may exist simply because human nature is such that individuals do not like to see negative results. Because these pressures can never be eliminated, internal audit reports must fully provide context for all findings and describe the potential impacts of each reported issue.

Exhibit 19 Pressure to Change Audit Findings (Department Size Comparison)



Note: Q77: During your internal audit career, have you experienced a situation where you were directed to suppress, or significantly modify a valid internal audit finding or report? Coupled with Q24: Approximately how many full-time equivalent employees make up your internal audit department? *n* = 10,092.

3.3 Source of the Pressure to Change or Suppress Audit Findings

The next question in the 2015 CBOK practitioner survey was related to the various *sources* of pressure to change audit findings. Responses are summarized in **exhibit 20**. Note that the survey participants were allowed to select more than one source of pressure; therefore, the responses do not total 100%.

As expected, most of the pressure put on CAEs to change findings came from management or another internal source, with the three most common sources being the CEO, CFO, and operations management. At least one of these sources was identified by 87% of responding CAEs. Surprisingly, CAEs also experienced pressure from boards of directors and audit committees (18%). Interestingly, more staff auditors than CAEs chose to respond, "I prefer not to answer."

Responses from directors and managers fall between those of CAEs and staff. Directors and managers (a) may receive pressure to change findings from within the internal audit department—presumably from the CAE; and (b) may experience pressure from all of the other remaining sources experienced by the CAE.

An unexpected result was the high percentage of staff (44%) and directors and managers (34%) who cited the internal audit department as the primary source of pressure. The data did not clarify the reasons for this result. From this author's previous experience, it is suggested that staff pressures arising from within the internal audit function might be due to a combination of factors that include:

- Lower experience levels may have led the staff auditor to raise issues that were not material to the audit.
- The staff did not appropriately communicate issues in drafts of audit reports (lack of good writing skills).
- There was poor communication between the CAE and the staff.
- There was a low level of political astuteness on the part of the staff.
- Less experienced auditors failed to identify the business issue tied to potential audit findings.

Exhibit 20 **Source of Pressure to Change Audit Finding (Comparison by Position)**

Pressure Sources	CAE Average	Dir/Man Average	Staff Average	Average
Internal audit department	9%	34%	44%	31%
Chief executive officer (CEO)	38%	24%	15%	25%
Operations management	25%	26%	21%	24%
Chief financial officer (CFO)	24%	18%	11%	17%
Other internal source	10%	16%	14%	13%
Source external to the organization	2%	3%	3%	2%
Board of directors	12%	9%	7%	9%
Legal or general counsel	6%	6%	4%	5%
Audit committee	6%	5%	5%	5%
Chief compliance officer (CCO)	3%	3%	3%	3%
Chief risk officer (CRO)	3%	4%	2%	2%
I prefer not to answer	8%	10%	15%	11%

Note: This exhibit only shows responses from those who indicated in a previous question that they felt pressure to change a finding. *n* = 2,564.

Insight: CAE and Staff Communication

Steve Minder, CEO of YCP Group, noted that CAEs need to do a better job of communicating why things need to be changed. He believes that CAEs need to spend more time on mentoring and training staff auditors across all dimensions, but particularly, on identifying and communicating issues that are very important to the organization.

There were a number of other interesting results from the 2015 CBOK practitioner survey regarding pressure exerted to change audit findings. Other observations are:

- Staff auditors felt considerable pressure (all percentages in double digits) from the CEO, CFO, operating management, and other internal sources.
- Approximately 12% of CAEs indicated that they received pressure from the board of directors, and an additional 6% cited pressure was received from the audit committee.
- Directors and managers reported receiving considerable pressure from internal sources, including the CEO, operations management, the CFO, legal, and other internal sources.
- Auditors at all experience levels reported receiving less pressure from the CFO than from the CEO.

3.4 Reasons for the Pressure

What are the conditions that would cause management or the board of directors to put pressure on an internal auditor to suppress or change an audit finding? Clearly, and this is important, some of the pressure can arise simply because there is a disagreement regarding the facts or the implications of the facts. *The Politics of Internal Auditing* refers to this as the "grey area." Most of the survey participants cited issues such as "The finding would reflect badly on management." (See **exhibit 21**).

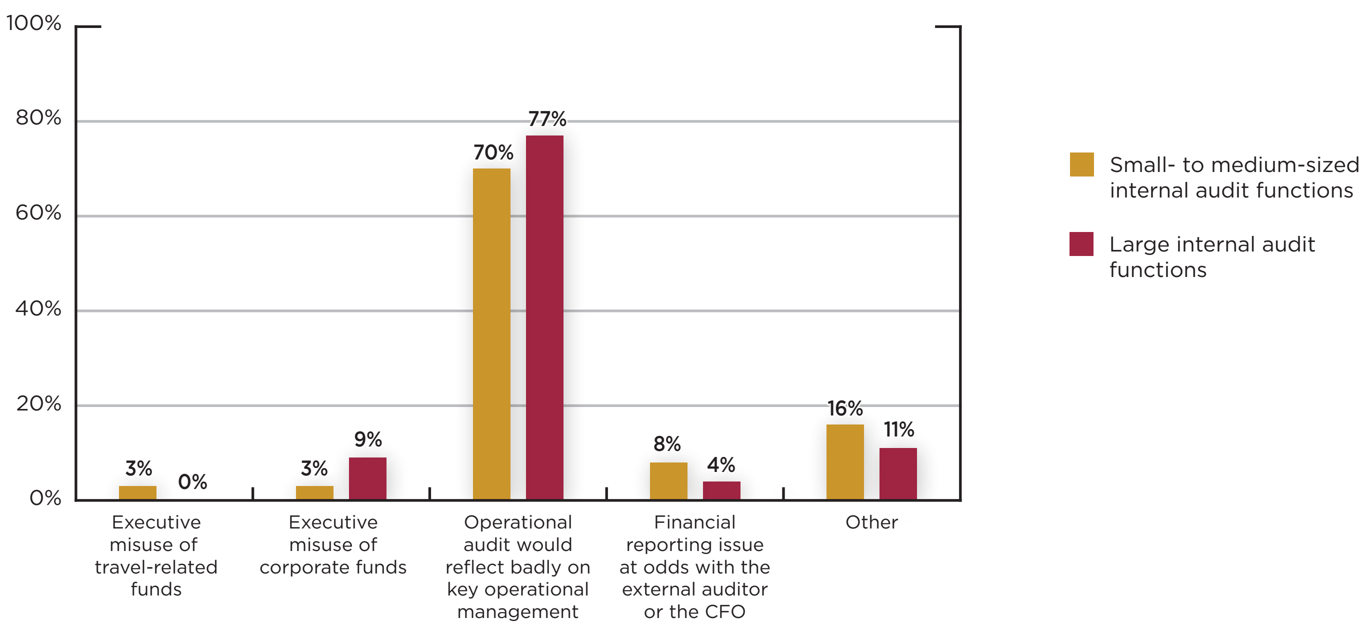
3.5 Repercussions from the Pressure

In a perfect world, internal auditors would always be sure of the "facts" related to their audit finding, and with the support of the audit committee (or equivalent), all findings would be addressed in a timely fashion. However, we know that we do not live in a perfect world. As indicated in **exhibit 22**, there may be consequences to resisting the pressure to change audit findings, which may include (a) pay cuts, (b) transfers to other positions, (c) terminations or being "eased into retirement," (d) budget cuts, (e) exclusions from important meetings, or (f) being ostracized by individuals in the organization.

When analyzing the responses from the 13% of participants that answered "other," we find some interesting answers. While each situation is unique, some of the more typical responses included:

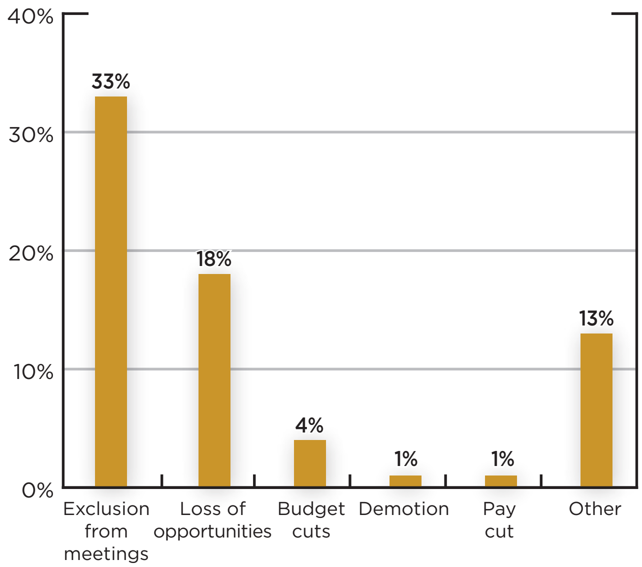
- Reduced communication from executive management
- Discrimination via gossip and second-guessing
- Job elimination
- Audit department outsourcing
- Hostile working conditions and stress resulting in health issues
- Pay raises for internal audit staff frozen, while others received pay increases
- Denied requests for additional internal audit department staff

Exhibit 21 Reasons for Pressuring Internal Auditors



Note: You indicated that you've been asked to suppress or significantly modify a valid internal audit finding or report. Which of the following best describes the nature of the situation? *n* = 278.

Exhibit 22 Consequences of Resisting Pressure to Change Audit Findings



Note: Have you or your audit team members experienced any of the following as a result of standing your ground on an audit issue?

Conclusion

Internal auditing is a unique function that requires business knowledge, organizational knowledge, and high levels of personal competencies. Given the potential pressures on internal auditors, it is essential that the audit function is designed to meet the stakeholders' expectations of adding value with insightful analysis. In an ideal environment, internal auditors should always be able to present findings without the threat of personal recrimination; however, the 2015 CBOK practitioner survey responses indicate that internal auditors do not always operate in such environments.

The survey results also demonstrate that the ethical environment can be improved. Too many organizations, do not have codes of conduct or codes of ethics. The framework to promote ethical behavior demonstrates a clear need for all internal auditors to adopt The IIA's Code of Ethics to help guide performance when they face ethical pressures.

About the Author

Larry E. Rittenberg, PhD, CIA, CPA, is professor emeritus at the University of Wisconsin-Madison and continues to teach and conduct research in the areas of internal auditing, governance, internal controls, risk management, and external auditing. He served as chairman of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) from 2004 to 2009 and is the author of numerous IIA Research Foundation studies, including *The Politics of Internal Auditing* (2015), co-written with Patricia K. Miller, and *Interacting with Audit Committees – The Way Forward for Internal Audit*, which is a component of the CBOK study.

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