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TONE at the TOP

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EXCLUSIVELY FOR SENIOR MANAGEMENT, BOARDS OF DIRECTORS, AND AUDIT COMMITTEES

# Doing the Right Thing

Most people likely would agree with the premise . . . When confronted with a decision, you often know the answer in your "gut" before it comes to your head. Some refer to this as the "body mind." Others simply call it "that little voice inside." Either way, it serves as a lifelong moral compass to many guiding the way to good choices, ethical decisions, and doing the right thing.

While making unethical decisions often is not a planned path, to wave one's personal or professional standards from time to time might not actually put a person on the road to degradation. However, such allowances can make way for a new, lower baseline against which future decisions will be assessed. And if this becomes a trend — with lower standards as the starting point for making choices in the future — one can find that previously long-held standards, themselves, have dissolved into thin air.

Lately, hardly a day goes by without more news of losses, both in the business world and the family checkbook. Frauds, foreclosures, bankruptcies, and unemployment have become oft-used terms all around the world, and it's anybody's guess when things will get better on the economic front.

***... with shrinking bonuses, disappearing raises, and even layoffs occurring in many companies, executive management and boards are challenged to foster a positive, productive corporate environment. But how do they get there from here? Where do they begin?***

Something that appears to be a precursor to most of this bad news is corporate greed, coupled with organizations turning a deaf ear to that internal voice that issues warnings and raises red flags. And as a result, fearful distrust has become the mindset of many.

Never is the "tone at the top" more visible or important than during difficult times. What can those at the top of their organizations do to help build morale, maintain high standards, exemplify corporate accountability, and ensure that appropriate and ethical choices are being made on behalf of stakeholders? And with shrinking bonuses, disappearing raises, and even layoffs occurring in many companies, executive management and boards are challenged to foster a positive, productive corporate environment. But how do they get there from here? Where do they begin?

This edition of *Tone at the Top* focuses on creating an ethical corporate culture — one that centers on doing the right thing — and provides five tips for maintaining such a culture through good times and bad.

### 1. Walk the walk.

While some organizations are led by very good talkers with charisma to spare, the cliché that actions speak louder than words is very true. Expecting others to fall into step when you are out of line yourself is a recipe for failure or, at best, self-deception. Exemplary leaders "walk the walk" by demonstrating what is expected, modeling good behavior, and adhering to the highest principles.

### 2. Achieve buy-in.

More than just a mantra to be heard, the desired state of an organization's culture requires the active agreement and participation of all. For example, in regard to risk and internal control, management is clearly responsible. And yet, setting an expectation of conformance with high standards for risk management throughout the organization is critical. Controls are everybody's business, and should not be viewed as something only to be considered by those at the top. Each staff member, from the mailroom to the front office, should be schooled on the importance of a collective consciousness about and commitment to a strong system of internal control, an unwavering code of ethics, and high standards of excellence.

### 3. Build the best team.

There's no substitution for integrity; either you have it, or you don't. Hiring people with integrity is the first step toward building a positive, productive, principled team. Second, ensure the skills of your employees are right for their roles. And finally, learn about your employees' strengths to ensure your organization gets the full benefit from their diverse expertise, insights, and experience.

### 4. Communicate openly.

The saying goes, "What you don't know won't hurt you." But secrecy and lack of transparency — especially in the corporate arena — often feed fear, distrust, and even disloyalty. Clearly, management sometimes needs to keep things under wraps as strategies are being considered and decisions are being made. However, always sharing as much information as is prudent with staff will go a long way toward dispelling myths, stopping the rumor mill in its tracks, and helping prevent a downward spiral of morale.

### 5. Promote a culture of doing the right thing.

Some organizations are on a mission to make money, no matter what. It's been said that Enron's corporate culture was a "trading mentality." Conversely, we've all heard of the banks that are faring very well these days because they made the ethical choice not to play the sub-prime mortgage game. Ensuring that goals and objectives are met without engaging in questionable business practices or doing harm to others is an admirable endeavor worthy of pursuit.

## INTERNAL AUDITING'S ROLES

Because this newsletter is published by The Insitute of Internal Auditors, regular readers likely expect it to examine the issues covered from an internal audit perspective. Still, few topics are more critical to the internal audit profession than ethics. And what other internal resource is better equipped than the internal auditors to help executive management and the board ensure that the corporate culture is ethical?

Internal auditing is performed by professionals with an in-depth understanding of the business culture, systems, and processes. They provide assurance that the internal controls in place are adequate to mitigate the risks, and that the governance processes are effective and efficient; and they help ensure that organizational goals and objectives are met. They help executive management ***walk the walk*** by making recommendations for improving and maintaining an ethical corporate culture. Rather than a service, internal auditing is a core activity that monitors and reports on the effectiveness and efficiency of operations, the reliability and integrity of financial and operational information, the safeguarding of assets, and compliance with laws, regulations, and contracts. All of this provides to management the assurance that things are as they should be throughout the organization.

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The internal auditors also are key to management's ability to ***achieve buy-in*** and participation in creating the desired ethical culture. A cornerstone of strong governance, internal auditing bridges the gap between management and the board, assesses the ethical climate and the effectiveness and efficiency of operations, and serves as an organization's safety net for compliance with rules, regulations, and overall best business

To ensure transparency and thwart collusion and conflicts of interests, best practice indicates that the internal audit activity should have dual reporting relationships. The chief audit executive should report to executive management for assistance in establishing direction, support, and administrative interface; and to the organization's most senior oversight group — typically, the audit committee — for strategic direction, reinforcement, and accountability. This reporting structure for internal auditors allows them to ***communicate openly*** without fear of reprisal or interference, and sets the stage for honest, straightforward feedback. It also allows the internal auditors to raise red flags, draw attention to concerns, and engage in further investigation as warranted.

**Just as proactively educating young people and preparing them for the future is less costly than incarcerating them after they commit crimes out of desperation, proactively mitigating risks in the business world is less costly than retroactively dealing with the repercussions of ineffective internal controls.**

practices. The internal auditors can help all employees understand their individual and collective roles in internal control and risk management, and can provide consultation and recommendations for improvement.

For the internal audit activity to be in conformance with the *International Standards for the Professional Practice of Internal Auditing*, external quality assessment of the activity is required at least every five years. The results of this assessment validate the internal auditors' proficiency, productivity, and processes. This assurance is music to the ears of those at the top who want to ***build the best team***. A broad range of skills and expertise, and ongoing professional development are critical to the formation and maintenance of an effective internal audit activity. Essential elements include in-depth knowledge of the organization's industry and best practices; technical knowledge, understanding, and expertise; skills for implementing and improving processes in both financial and operational areas; and strong communication and presentation capabilities. Individual designations, such as the Certified Internal Auditor® (CIA®), earned by internal audit staff members further validate the internal audit activity's proficiency and capabilities.

While others in an organization might notice things that are "not quite right," they likely will justify not speaking up because they are not privy to the whole story or they think it is someone else's job to step forward. Hopefully, though, they will report their insights to the internal auditors, who are well positioned to see the big picture and assess whether concern is warranted. The internal auditors have access to all areas of a company and understand that it is their job to identify things that are not right. In addition, they are totally attuned to that "internal voice," trained to recognize the warning signals, and knowledgeable about how to be a part of the solution. By performing their varied roles, the internal auditors inherently ***promote a culture of doing the right thing***. In some companies, however, the organizational structure does not allow the internal auditors to demonstrate their great value to management and the board, and this truly is unfortunate. In order to be effective they must be both heard and heeded, for it is only through recognition and empowerment that the internal auditors can truly make the difference.

In short, helping ensure the company does the right thing is what internal auditing is all about. What more could those at the top hope for, especially in times like these?

TONE at the TOP
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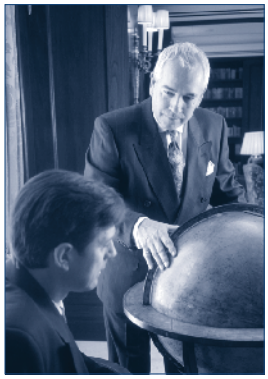

## Mission

To provide executive management, boards of directors, and audit committees with concise, leading-edge information on such issues as ethics, internal control, governance, and the changing role of internal auditing; and guidance relative to their roles in, and responsibilities for, the internal audit activity.

Your comments about *Tone at the Top* are welcomed.

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The IIA is the global voice, recognized authority, chief advocate, principal educator, and acknowledged leader in certification, research, and technological guidance for the internal audit profession worldwide. The IIA enhances the professionalism of internal auditors and is internationally recognized as a trustworthy guidance-setting body. It fosters professional development, certifies qualified audit professionals, provides benchmarking, and through The IIA Research Foundation, conducts research projects and produces educational products.

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