

Ethics & Compliance Audits: An imperative Solution in Present Times



Over past decade, the subject of ethics and compliance in entities of various kinds and sizes has achieved a multifold significance not only for organisations on which they apply but also for practitioners of governance, legal experts, auditors, federal consultants, their advisors and mentors, in order to attain the disciplined performance of ethics and compliance processes, and for those responsible for oversight. The ever increasing organisational frauds and ethical failures has led to continued legislative and regulatory mandates for quality governance practices. Along with this, a steady increase in organisational spending and the recent high-profile criminal and civil fraud matters involving internal & external parties to an organization, has resulted in the surfacing of demands for closer scrutiny. To solve the difficulty of complying with innumerable multifold laws and regulations, and to have a ceaseless oversight in this regard, we have a saviour in the name of E & C (Ethics & Compliance) Audit. Where organisations do not wish to outsource the E & C Audit exercise, they develop & establish an Ethics Compliance Program as an internal control exercise, which enables them in building not just a culture of ethical behaviour, but also prevent, detect and eliminate regulatory violations, fraud and abuse, if these were detected. Read on to know more...



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In addition to this ever-increasing monitoring by historical & new laws, regulations & federal amendments impose additional compliance and disclosure requirements. In such an extreme regulatory business environment, it becomes indispensable to ensure that a company's strategic & ethical policies, practices and procedures conform to current federal, state, local & international laws and regulations. Thus, it becomes a crucial requirement for organisations to align their governance processes and also enlighten responsible executives with regard to all developments affecting organisational ethics and compliance in order to streamline their functioning with the requirements of all applicable laws and standards of operation in their country. To solve this difficulty of complying with innumerable multifold laws and regulations, and to have a ceaseless oversight in this regard, we have a saviour in the name of E & C (Ethics & Compliance) Audit.

Before we get to know what Ethics compliance audit deals with and does, it is pertinent on our part to understand in layman language what we mean by Ethics & Compliance in general. Compliance is what we have to do, while ethics is how we choose to do it. Compliance with an organisation's policies and procedures is essential, as it ensures effective organisational governance. Compliance checks & balances are maintained not just to keep the regulators satisfied, but it is indispensable to an effective enterprise-wide risk management programme. Not just that, it also results in attainment and securing organisation business goals and thus promoting sustained ethical health and prosperity.

E & C Audit: A Monitor to Compliances

The Ethics Compliance Audit involves monitoring and reviewing compliance activities by conducting an annual risk assessment and developing a Compliance Work Plan to ensure that the organisational ethics policy is being followed. The Ethics Compliance Audit also involves monitoring and auditing identified high-risk compliance areas in an organisation. These reviews are aimed at ensuring adherence to general compliance policies and applicable federal and state laws and regulations. The reviews cover a wide range of compliance activities including campus/unit-wide risk assessments, mitigation efforts, policies and procedures, compliance training, specialised training in areas such as grants and research, compliance with federal agency agreements, grant accounting procedures, trade and procurement agreements in the light of effective regulations.

The major purpose of Ethics Compliance Audit is to identify, avoid, and mitigate risks by fostering a culture of ethical behavior, marked by integrity, openness, honesty, accountability, objectivity, credibility and compliance with all applicable laws and regulations. These specific behaviours must be followed by everyone as an element of corporate citizenship and business necessity. Ethics Compliance Audit helps to identify & implement the highest standards of compliance and ethics. At the same time, it helps to ensure that Values and the Standard Code of Conduct which are imperative to organisational growth & fulfillment of regulatory compliance requirements, are maintained. It enables the organisation to live these core values and take prompt and appropriate action, when the behaviour of other individuals within or external but related, contradicts its established standards and policies.

Ethics & Compliance: An Internal Issue

Where organisations do not wish to outsource the E & C Audit exercise, they develop & establish an Ethics Compliance Program as an internal control exercise which enables them in building not just a culture of ethical behaviour, but prevent, detect and eliminate regulatory violations, fraud and abuse if these were detected. It involves putting emphasis on providing all employees with policies, procedures, informational resources and training that promote law abiding and ethical actions in all workplace conduct. This is accomplished by identifying institutional risks; performing audits, reviews and investigations; and augmenting compliance through effective education and training programs. Ethics Compliance Audits help organisations to tap unwarranted activities and processes being followed within an organisation, which are in complete contravention to the requirements of the Federal, state, local laws and regulations, thus enabling entities, be it a hospital, a university, a business organisation, or any other institution to continuously comply with local, national and international norms and regulations applicable in the arenas of their operations. The ethics compliance check ensures that organisations comply with their own internal policies, procedures, highest standards of integrity, and accountability for the fulfillment of applicable requirements and regulations. Usually, it is seen that all the constituents of the organisation are not acknowledged about all the laws and policies that apply to the organisation concerned, they are still expected to know and follow those that apply to their specific job function, including the business code of ethics and policy guidelines at large.

E & C: Indispensable in Global Business Perspective

The most crucial advantages of having an Ethical Compliance Audit is that, it helps in maintaining an ethical work environment and thus promoting the prevention, detection and resolution of potential violations of laws or policies applicable. Considering ethics compliance in the global perspectives, it is seen that it tries to identify and assure that the activities, processes and procedures followed in an organisation are in consistency with the criteria outlined in the US Organizational Sentencing Guidelines (the "Federal Sentencing Guidelines"), Sarbanes-Oxley, Securities regulation act, International trade practices, Foreign corrupt practices act, Emergency Medical Treatment and Active Labor

Act (EMTALA), SEC and New York Stock Exchange rules, FERA, FEMA, Federal gift & gratuity laws, other applicable laws and subsequent amendments. It is very amusing to know that even today, in many countries, the use of a formal compliance and ethics office is not that common, whereas in United states of America due to the U.S. Federal Sentencing Guidelines and various governance regimes that are in place (e.g. the 2002 Sarbanes Oxley Act and Bill 198 in Canada) a Compliance & Ethics Audit (C & E audit) has become commonplace in supporting the improvement of governance practices within an organisation. On an overall basis through ethics compliance audit, an organisation fulfills its responsibilities towards governmental guidelines in place as well as gains an appropriate oversight, monitoring and support of all compliance functions. In addition to this, it accomplishes the coordination of departmental or other compliance initiatives, internal monitoring and reporting support, and acting as an additional resource for raising compliance concerns.

E & C Audit Along With Ethical Polices Making It Easier

Through Ethics Compliance Audit, the auditor provides support to a broad set of ethical business conduct principles that will reduce the prospect of criminal and other improper conduct. As we all know, organisations have their own ethical policies, code of conduct & ethics measures through which standards are delivered in writing and appropriate training is ensured for all employees to guide them all, including top management about the specific regulations, policies and procedures that must be followed for compliance reasons. These ethical codes of conduct in an organisation encourages adherence to institutional, business unit, and departmental procedures created to effect delivery of efficient services while operating within a compliant environment.

Formally, it is seen that organisations develop a sound ethics & code of conduct policy for their overall and day-to-day functioning, but enacting policies comes out to be only good control if it is also assessed at regular intervals, whether the organisational transactions and dealings fairly comply with all the relevant established policies and other federal and state laws.

Organisation Culture: A Path to Ethical Compliances

Organisation culture which can be attained through the creation of the Ethics policy & Code of conduct

is one of the most important building blocks for a highly successful organisation and an extraordinary workplace. Thus organisational culture is defined as the set of shared beliefs, truths, assumptions, and values that operate in organisations. Organisational culture has been described as "how people behave when no one is looking." Values in an organisation shape their culture thus defining the way to get things done.

Considering the holistic view, Ethics Compliance Audit helps organisations to ensure that organisational processes operate in an accurate, timely & reliable way. It involves assessment of:

- Overall efficiency of operations
- Adequacy & effectiveness of internal controls
- Credibility & reliability of financial data
- Effectiveness of asset controls
- Compliance with Organisational policies and procedures

Processes in Ethical Compliance Audit

Typical functional areas audited to ensure compliance of specific laws & regulations include: cash receipts and revenues, procurement and disbursements, payroll and staffing, cost control, taxes, capital equipment, physical safety, grants, sponsorships & donations. Not only the financial aspects of these transactions are taken into the picture while reviewing, but the ethical aspect & policy assessments are also adjudged. Before initiating the audit exercise, an auditor tries to understand the documented ethics policy of the organisation. For that, answers to the following questions are gathered through preliminary investigation, using time-tested tools of observation, inquiry and interview.

- Are policies & procedures documented?
- Are they readily accessible by all organisational personnel?
- Are they current & up-to-date?
- Are they being followed religiously?
- Are deviations from the ordinary or the documented procedure identified & reported adequately.

Adequate documentation helps the auditor to identify practices in place and augment his awareness of exceptions. Understanding policy documentation significantly helps the auditor to plan & identify the areas to audit that enables him to have a positive and aligned audit experience.

The auditor should conduct a comprehensive audit risk assessment - that is, one should identify the key risks facing the company's compliance and ethics efforts and use these to decide where to concentrate

the audit. The activities covered by the organisation's compliance and ethics programme, together with its aims, will determine the scope of the audit. If the organisation does not have a formal compliance and ethics program, the audit could begin with a gap analysis which involves comparing actual practice with what might be more desirable if the organisation already had working program and what might be areas of crisis. Where there is no formal E & C program established, auditor should check whether there is consistency and integration of compliance and ethics programme among the different business units within the organisation, whether there is coordination between the compliance and ethics officer or those responsible for overall ethical compliance and individual business units, whether segregation of duties & dual check mechanism has been ensured over the operations of the ethics office (if in existence), compliance, human resources, legal, and other relevant business units; and last but not the least, whether the board and senior management has effectively set the tone for compliance and regulatory requirements.

Ethics & Compliance Audit: An Additional Check

Audits usually have the same course and procedure, except the scope and audit areas to be covered change, as per the purpose and direction of audit engagements. Laws and regulations applicable for which compliance diagnosis is to be made, also help to single out or put one's finger on most audit concerns. Ethics compliance audit also follows the same route but they serve different purposes as compared to traditional financial audit. Compliance audit helps organisations to adhere to federal, state, and local laws and regulations as well as organisational policies. Here the auditor looks for compliance risks and facilitates the development of action plans to mitigate them. Compliance assessment usually involves evaluations of organisational processes, procedures & controls. Through discussions with responsible unit compliance representatives, the auditor evaluates the unit's programmes and functioning against the compliance framework. Areas of concern are identified, mitigation strategies are designed, and senior management is informed about the results. Every organisation works under a matrix of regulations. In all organisations, several units and individuals have a key role in managing compliance, in order to continually maintain inventory of all compliance requirements and their follow ups. Ethics compliance auditor during the audit exercise develops ongoing partnerships with unit representatives to monitor compliance and identify emerging issues.

Ethics & Compliance Committee: Purpose

Enterprises today also choose to establish an internal ethics compliance committee, which acts as an information-sharing and awareness raising advisory group that provides leadership and helps ensure accountability for necessary compliances. These committees accomplish this by providing for ethical compliance programs, thus identifying and evaluating institutional risks and communicating recommendations to senior management to aid in remediation efforts. The E & C Committee serves as a channel of communication and an internal resource. Its primary objective is to assist the management to fulfill its responsibilities in an ethics-based environment that is compliant with applicable laws, rules and regulations and in which the public trust is maintained.

Objectives of Ethics & Compliance (E & C) committee

- Implementing a code of conduct in the organisation
- Managing an environmental management system
- Maintaining an entity's quality management system
- Identify all organisational functions involved in compliance activities
- Define the major components of an effective compliance programme
 - ❖ Determine if key components are in effect and have been documented by each area of compliance jurisdiction
 - ❖ Critique the results of each unit's determination
 - ❖ Assess and prioritise risks in each area of jurisdiction
 - ❖ Identify significant compliance risks not being adequately addressed within a unit's organisational structure for elevation to senior management
- Compile universe of compliance matters (laws, regulations, or other binding rule/agreement) related to each area of jurisdiction
- Participate in discussions aimed at identifying, prioritising, and remediating institutional risks
- Share information relevant to other compliance functions to seek remediation
- Review organisational compliances to legal issues, current and pending litigation which has financial risk exposure, significant proposed legislation, compliance with business ethics and code of conduct, significant cases of employee conflict of interest, misconduct or fraud
- Aid in identification of cross-jurisdictional issues where exposures may not have been addressed
- Evaluate the institutional risk associated with

emerging compliance issues and ensure that accountability has been established

- To help the organisation fulfill its commitments to ethics and compliance by providing members with the information needed to act appropriately.
- Providing a framework for administering organisational resources and establishes guidelines for acceptable standards of behaviour.
- Undertake research in the areas of compliances and regulations
- Ensure adherence to key compliance regulations with regard to overall conflict of interest policy, employee compensation, organisational employment practices liability & performance management and evaluation.
- To conduct internal ethics compliance audit, ensuring organisational compliances with financial & reporting controls i.e. compliance with accounting standards, government and legal requirements, management of overall financial risks, checking compliances with policies covering the control of assets and information systems and with policies and procedures relating to the prevention, detection, and investigation of fraud and corruption.
- To ensure that Ethics Policy governs official conduct as well as to identify & take immediate action on alleged violations which may result in disciplinary action including dismissal or termination.
- To provide for EthicsPoints or EthicsSpots to the organisational members and personnel, in order to facilitate reporting of activities that may involve misconduct or violations of organisational policy.

As far as EthicsPoints/EthicsSpots are concerned, normally the whereabouts of those reporting ethical misconducts are kept confidential considering regulations of state whistleblower protection policies & specific policies of organisations in this regard. These EthicsPoints service is not a substitute for, nor does it override any existing reporting methods or protocols already in place at the organisation for reporting suspected problems or complaints. Instead, the EthicsPoint /EthicsSpots system provide an over-the-edge means of reporting such issues. Any suspected problems or complaints reported via EthicsPoint/ EthicsSpots are reviewed in accordance with current organisational procedures, including those described in the organisational policy documents. It is also ensured that no retaliatory action against anyone is taken for reporting or inquiring

about potential breaches of institutional policy or where one seeks guidance on dispensing suspected breaches.

Types of E & C Committees

Several incidental & coordinating committees are established along with the main Ethics Compliance committee within the organisation where this exercise of E & C programme is ensured internally, to guarantee proper execution and attainment of objectives as stated above. These committees usually consist of:

- **Ethics & Compliance Committee:** This is the principal committee which facilitates & forwards guidance to the Company regarding the direction of the Company's ethics and compliance and quality of care programs and receives regular reports regarding the status and welfare of the program.
- **Corporate Ethics and Compliance Steering Committee:** It comprises of senior management at the corporate level and is responsible for setting the direction of the ethics and compliance program, receiving reports regarding monitoring and auditing within the program and approving major expenditures.
- **Corporate Ethics and Compliance Policy Committee:** It comprises of management at the corporate level and Chief Executive Officer. This committee has responsibilities for approving policies and procedures and related educational materials.
- **Facility Ethics and Compliance Officers:** Each facility has an Ethics and Compliance Officer who is responsible for the implementation of the ethics and compliance program in his or her facility/department.
- **Legal Executives:** Individuals within the corporate office have been identified as the subject matter experts in particular areas of compliance risk and named Responsible Executive for those areas of risk.

Ethics & Compliance in the light of Global Laws & Regulations

SOX

In the current turbulent times where the need for stronger ethical standards is the talk of the town and the most desperate requirement, it becomes indispensable to have some catalyst to keep that flame of hope ignited and alive. Sarbanes Oxley Act 2002 abbreviated as SOX is the torch-bearer for ethical compliances, ensuring checks & balances on

those corporate executives who advertently certify inaccurate financial statements. SOX have been successful in increasing corporate focus on a strong ethical culture in publicly owned companies, as well as among auditing & assurance concerns. This act was enacted to put a tab on similar accounting scandals and fraud witnessed in 2002. The act specifies a code of conduct requirements with respect to financial practices, accounting controls, conflict of interest, corporate governance and disclosures and calls for hefty fines and upto 20 years imprisonment for securities violations.

Foreign Corrupt Practices Act

This act marked the initiation of compliance programs in the United States. The decade starting with 1970 is historic for its overseas bribery scandals in which a significant number of American companies participated. In such tormenting times, in order to restore faith in American business, the Foreign Corrupt Practices Act 1977 was enacted. This regulation requires member nations to designate the payment of bribes to foreign offices as a crime and to follow the rules and regulations that govern bribery in international transactions. It applies to a foreign company or person, if such company or person either directly or indirectly through agents, engages in acts which further the facilitation of corrupt payments taking place within the territory of the United States.

Committee of Sponsoring Organizations of the Treadway Commission (COSO)

COSO was formed to develop guidance on internal controls. COSO Internal control framework has become the *de facto* standard in the accounting industry for auditing, evaluating and monitoring internal control systems. It is now widely used by most organisations as the basis for “establishing and maintaining an adequate internal control structure and procedures for financial reporting” & for the assessment of control effectiveness.

United States Federal Sentencing Guidelines

These guidelines describe the elements of an organisation’s compliance and ethics programme that are required to be considered for eligibility for a reduced sentence if convicted. In general, it requires an organisation to establish standards to guide its employees and agents. These standards must reflect government regulations and industry standards and apply to almost all types of organisations including

corporations, partnerships, unions, non-profit organisations and trusts. These guidelines also require directors and executives to take an active role in the management of its compliance and ethics program and the importance of promoting an organisational culture that is compliant with the law and demonstrates ethical culture. These guidelines require organisations to follow minimum requirements for an effective compliance and ethics programme.

**Ethics & Compliance in the Light of Native Laws
The Prevention of Bribery of Foreign Public Officials Bill, 2011**

Bill, though pending in Parliament, makes provision for dealing with bribery among foreign public officials (FPO) and officials of public international organisations (OPIO). This bill criminalises acceptance or solicitation of bribes by FPO and OPIO for acts or omissions in their official capacity, offering or promising to offer a bribe to any FPO and OPIO for obtaining or retaining business, abetment or attempting either of the above acts. Any person who commits offences under the Bill shall be liable to imprisonment between six months and seven years and a fine.

The Anti-Corruption and Whistle-blower Protection Bill, 2011

Bill, though pending, seeks to establish a mechanism to register complaints on any allegations of corruption or willful misuse of power against a public servant. The Bill also provides safeguards against victimisation of the person who makes the complaint. The Bill aims to balance the need to protect honest officials from undue harassment with protecting persons making a public interest disclosure. It punishes any person making false complaints. However, it does not provide any penalty for victimising a complainant.

Competition Act 2002/(Amendment) Bill, 2012

The Competition Act 2002 prohibits any agreement that adversely affects competition in India. Act prevents any enterprise or group to abuse its dominant position. The Amendment Bill pending extends this by preventing any enterprise or group, jointly or singly, to abuse its dominant position. The CCI has the power to inquire into agreements and abuse of dominant position & also to impose penalties for anti-competitive agreements and dominant position abuse.

Clause 49, Listing Agreements SEBI

Clause 49 of the Listing Agreement to the Indian

Stock Exchange came into effect as on 31st December 2005. It has been formulated for the improvement of corporate governance in all the listed companies. It provides for requirements stating that at least 50% of the board should comprise independent directors. In the case of a company with a non-executive Chairman, at least one-third of the board should be independent directors. It makes mandatory for chief executives and chief financial officers to establish and maintain internal controls and implement remediation and risk mitigation towards deficiencies in internal controls, among others. It requires all companies to submit a quarterly compliance report to the Stock Exchange in the prescribed form. The clause mandatorily asks for separate section on corporate governance in the annual report with a detailed compliance report. It asks the company to obtain a certificate either from auditors or practicing company secretaries regarding compliance of conditions as stipulated, and annex the same to the director's report.

Consumer Protection Act/ (Amendment) Bill, 2012

The consumer protection bill also ensures a check over unethical practices of mischievous entities. It promotes and protects the rights of the consumers against the marketing of goods and services which are hazardous to life and property, to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices, to be assured, wherever possible, access to a variety of goods and services at competitive prices, to be assured that consumer's interests will receive due consideration at appropriate forums & secures right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers.

All these regulations aim to create stricter regulations and have given more credibility to its fight against unethical, corrupt practices/corruption within corporate world and bring them to light. There is a need for harsher implementation of all laws and regulations in the country to help the country recover from the setbacks it has faced and protect the interest of various stakeholders.

Several others bills & regulations are ensuring that organisations become more aware and keep oversight over there ethics and compliance requirements. Some of these include:

➤ *Companies' (Auditor's Report) Order (CARO) 2003*:- It entrusts the responsibility of preventing

corporate fraud to the Directors, CEO, CFO and auditors of a company.

- *The Prevention of Corruption Amendment Act*:- The Act has powers to deal separately with the offence of violating the norms of the Constitution, for using undue influence on public servants, misusing official powers and causing loss to the government exchequer. It has been vested with powers to seize, attach and confiscate the property of convicted persons, who have amassed ill-gotten money
- *Companies Act 2013*:- It has vested special powers in Serious Fraud Investigation Office (SFIO) to probe companies suspected of fraud.
- *Data privacy laws*: These provide for abuse or gathering of personal information without the knowledge of the concerned persons. It seeks to protect personal & financial information such as bank accounts, credit or debit card or other payment instrument details from being abused.

Conclusion

Ethics Compliance Audit is not merely an audit of Ethics & Compliance programmes in an organisation but in the tormenting & skeptical times of corporate failure and ethical lapses, they are seen as a saviour for public interest & stakeholder protection. It will be a matter of great pride if organisations around the world take ethics and compliance procedures as their corporate fiduciary and social responsibility. In the times of ever-increasing business opportunities and cut-throat competition, the possibility of corporate lapses can't be written off completely, which in turn ensures the significance of Ethics Compliance Audits, to put a tab on unwarranted ethical lapses in the decades to come

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