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THE IMPACT OF ETHICS ON QUALITY AUDIT RESULTS

Abstract: As organizations have become more complex and sophisticated to meet future demands, the reliance on audit results as a ground for proper decision-making is amplified. It is usually believed that ordinary moral sensibility, along with good example of more experienced colleagues, will be sufficient to safeguard ethical side of the business. However, the evaluation on audit quality is a rather difficult to conduct because researchers are not in position to monitor in vivo how an audit is carried out. Therefore, the influence of audit team competence becomes crucial to judge about quality audit results. Auditor technical skills are important and they can be measured and tracked. On the other hand, personal ethical skills remain mainly hidden although their influence may bias quality audit results. The paper deals with various aspects of influences that may jeopardize objectivity of quality audit results, including the relations between the team leader and the team member whose joint performance may also generate adverse effects on final audit result.

Key words: quality audit, ethics, personal skills, ethical climate, auditor

1. INTRODUCTION

Although in today's practice auditing is predominantly understood as the main technique to set a diagnosis for management system performance, it has origin in financial application. Upon industrial revolution money lending activity became widespread with raising importance for trade and national economies. Such an activity introduced the need for external and unbiased assurance that both parties (lenders and borrowers) are telling the truth. The task of an auditor was to examine the records and to assess truthfulness by matching recording information against accounting requirements. Grounding on belief that auditors are unbiased, stakeholders regard such reports as truthful, (Arter, 2003).

Despite the growing international

literature in this issue, not sufficient attention has been given to ethics in the training of auditors. Provided the expertise is not lacking, it is assumed that ordinary moral sensibility, along with the good example of more experienced colleagues, will be sufficient to safeguard ethical side of the business. Attention to the ethics of auditing engages the professional firms only with respect to risk minimization in relation to the serious illegal activities of the occasional 'bad apple' and the likelihood of legal liabilities and a general concern for their reputation. Under such circumstances, it is understandable that research into the ethics of accountants and auditors is focused on discovering how to improve compliance with generally accepted principles of professional conduct, (Campbell, 2005).

Ethical disagreement about auditing

arises, partly, since there is no agreement as to what the central purpose of an audit is. And since the ethical significance of the conduct of individual players in the audit depends on the moral justification of the system in place, disagreement about the purpose of the audit generates disagreement about how audits ought to be conducted. This means that, although ethics in auditing does involve the conduct of auditors, any serious attempt to assess that conduct must take account of the nature and purpose of auditing and the economic and social functions it is intended to serve. Evaluating auditor performance requires, for instance, raising questions as to what constitutes conformity with official guidelines and the standard of professional practice, and about the attitude of those involved to auditing and accounting rules, legal and otherwise, and the ways in which they are interpreted and applied. It requires reference to the systems for decision-making and control within auditing firms, and the openness and honesty of the corporations under audit. All this goes far beyond seeking conformity with obvious and agreed standards and conduct.

2. ETHICAL INTELLIGENCE AND ETHICAL CLIMATE

The key expectation from auditors lies in the fact that they are called upon to give social legitimacy to their clients. When financial audits are concerned they can be understood as a social mechanism of control the objective of which is to reproduce trust. However, to be able to meet the expectation of the guardian of reliability of financial transactions, they shall be irreproachable, at least in ethical sense, (Pasewark, 1995).

Principally, ethical issues are to be taken into consideration once two criteria are met: volition and consequences. First, the individual dealing with an ethical issue must have a choice. Secondly, his choice must have consequences for the others. If the action of an individual has no consequences

for the others, it can not be considered an ethical issue, (Bartels *et al.*, 1998).

Ethical intelligence depends on three ethical qualities: moral awareness (or ethical sensitivity), reflection skills (abilities to judge from a critical distance) and moral imagination (ability to develop new structures of thinking). Rest (1986) describes ethical decision-making as a four-step process that includes following: recognition of a moral issue, evaluation of the information received and available options, intention to make decision, and subsequent behavior or mere decision. However, when ethical behavior is concerned, Kohlberg's theory (even from 1969) is used as the ground by most authors. Kohlberg postulates that cognitive structures and interpretative processes determine ethical decisions. He proposes three broad levels of sophistication in ethical reasoning. The first is called the "pre-conventional level". On this level, individual decisions are determined by self-interest. The second level is the "conventional level". The individual is concerned about the expectations of others and relies upon rules and regulations to determine what is right. On the third level, the post-conventional level, the individual decides what is right or wrong using universal ethical principles such as justice and fairness. When auditors are concerned it becomes apparent that ethical sensitivity has a direct influence on ability to resist "client pressure". In that regard, based upon level of cognitive development, three auditor types may be distinguished: "self-governing", "pragmatic", and "accommodating", (Windsor, 1996).

The expression "ethical skill" determines the ability of an auditor to produce ethical judgements. On the other hand, ethics has already been introduced as a key element in a competency model. Cheetham and Chivers (1998) developed an holistic model of professional competency, comprising of five sets of interconnected competencies including cognitive skills (theory and concepts, as well as

informal tacit knowledge gained through experience), functional competencies (skills or savoir-faire are qualities that a person who works in a given occupational area should be able to demonstrate), personal competencies (behavioural competencies defined as a relatively enduring characteristic of a person causally related to effective or superior performance in a job), ethical competencies (defined as the possession of appropriate personal and professional values and the ability to make sound judgments based upon these in work-related situations) and meta-competencies, concerned with the ability to cope with uncertainty, as well as with learning and reflection.

From the perspective of a certification body (containing the pool of auditors) the ethical climate appears as a convenient performance indicator. Ethical climate is “the shared perception of what behavior is right” and is “based on members’ perceptions of typical organizational practices and procedures involving ethics”. Ethical climate is characterized by two elements: strength and dimension, (Murphy, 1993). Strength refers to the extent of control over behavior in the organization. Does the firm send clear messages about the behaviors it expects? What are the rewards and the punishments related to ethical or unethical behavior in the employees? Dimension is the content of the norms and procedures controlling ethical behavior.

3. CODE OF ETHICS FOR AUDITORS

Since ethics appears to be a significant factor in planning and conducting a quality audit, there is a need to establish a set of rules in that regard. Such document, preferably a Code of Ethics, can affect the eligibility of the auditing organization and the individual auditors just as much as the type of audit to be undertaken, (Mills, 1989). A code is of major importance to help auditors attain full objectivity in their

observations and subsequent analyses. Such objectivity must not only be demonstrated in practice; it must become evident to all parties associated with the audit, but also to others related to the activities linked with audit either directly or indirectly. In other words, the auditor is in position not only to be pure but also to be seen in the same way by all the others.

A Code of Ethics shall provide certification body to be beyond suspicion and reproach thus to be regarded with respect and trust. Auditor should conduct themselves which promotes good relations between auditors and the sector. It must be taken into account that public confidence and respect one auditor enjoys is largely the result of cumulative accomplishments of all (past and current) auditors. Therefore, it is of common interest (which includes general public) that the auditor communicates with fellow auditors in fair and balanced way, (INTOSAI, 1998).

Integrity is the value of supreme importance for a Code of Ethics. Auditors are obliged to strictly adhere to high behavior standards during their work but also in all communications with staff of audited organizations. Integrity can be measured in terms what is right and just. It requires auditors to be aware of both the form and the spirit of auditing standards. They are also expected to observe the principles of independence and objectivity, maintain irreproachable standards of professional conduct, make decisions bearing in mind public interest and last but not least demonstrate absolute honesty in their work.

Independence from the audited organization and other interest group is indispensable prerequisite to conduct an audit. Auditors should strive not only to be independent of audited organizations and related interest groups, but also to be objective in dealing with the issues under consideration. It is not sufficient to be impartial only by fact, but also in appearance and personal conduct.

There is a multitude of temptations caused by personal or external interests that could impair auditor's independence. Such situations may arise due to presence of external pressures or influence upon auditors; any preconceived opinion an auditor holds about audited individuals, entities or projects; recent previous employment or interest-related communication with the audited organization; or personal/financial which may cause conflict of loyalties. Since majority of issues are mostly personally identifiable, it is auditor's personal obligation to refrain from becoming involved in matters where a vested interest may be recognized.

Auditors should make use of information given by audited entity and other parties. The information is to be regarded in the opinions expressed by the auditors in an impartial way. The auditor should also gather information on the views of audited organizations and others involved. However, the auditors' own conclusions shall not be influenced by such views, (INTOSAI, 1998).

Political influence either exerted on certification body or auditor personally may jeopardize trust in quality audit outcome, particularly in countries in transition where interests of particular groups are not distinguished enough. To safeguard audit results objectivity it is important that auditors where undertake or consider undertaking political activities be aware of the impact such activities may have (or generate such impression) on ability to execute their professional duties impartially. Although political engagement can't be restricted, situations generating professional conflicts are likely.

The issue of conflict of interest is particularly sensitive for quality auditors since it is extremely difficult to standardize situations where conflict of interest arises. Where auditors are allowed to provide services other than audit to an audited organization, special attention should be paid

that such services does not generate a conflict of interest. In that regard, auditors should ensure that such advice or services does not include management responsibilities, which have to remain entirely within the management of the audited organization. Auditor's independence should be safeguarded through refusing any gifts or gratuities that may affect or might be perceived to affect their integrity and independence. Particularly in small sectors when is it not likely that auditors have had no communication with the audited organization before, auditors should take care to refrain from relationships with managers and staff of audited organization that may compromise or threaten the ability of auditors to act or to be perceived to act independently. Gratuities made to auditors can hardly be traced but they may impair objectivity of an audit to a great extent. In this sense, should take care not to establish such relationships with audited organization in which their official position as an auditor may involve risk of corruption or may generate doubts in their objectivity and independence. Generally, for a quality auditor it is not sufficient to be self-confident in own objectivity and independence; he also has to secure that such perception of his conduct is shared by all interested parties.

Professional development of an auditor may be regarded as ethical issue, as well. Auditors have a continuous obligation to update and upgrade the skills required for the discharge of their professional responsibilities. This includes not only to improve their potentials but also to implement highest possible quality in their audits, but still to adhere to basic postulates and generally accepted auditing standards.

4. ETHICAL CONDUCT OF QUALITY AUDIT PLAYERS

Generally, in performing an audit, each quality audit team member should always

strive to be objective in judgment and subsequent explications. Only the facts should be regarded on assessment of whether conformance exists between criteria and the implemented programs. The auditor should express his opinion not before it has been grounded on sufficient knowledge and just conviction. In other words, facts should speak for themselves and opinions should be substantiated by objective evidence, (Baysinger, 1997).

4.1 Team leader conduct

To be ethically commendable the quality team leader should serve as a supervisor and remain willing to recognize good work and offer constructive criticism for involvement in performance. The lead auditor has to demonstrate through actions how the audit team should conduct and the team leader must demonstrate leadership and set good examples. The team leader shall require the rest of the team to fully comply with the rules, regulations, codes and customs of hosting organization. Such behavior includes compliance with the working hours, dress, lunch hours and other requirements. Team members should tend to blend into the environment which they are auditing in. Any action taken by the team which makes it stand out reduces its effectiveness in dealing with audited organizations, (ASQ H0520-1986).

When any problem between the audited team and auditing organization arises, the team leader must demonstrate fairness to both parties. All actions towards obtaining the facts and settle any personality conflicts taken by the leader have to be grounded on objectivity. Once there is a significant doubt remaining as to verification of facts or correctness of the finding, and additional evaluation fails to eliminate doubt, the item should be dropped or offered in terms which acknowledge the degree of uncertainty at the closing meeting. The selected type of action demonstrates the objectivity and fairness of the audit, (Baysinger, 1997).

Should personal conflict take place between audit team members, the team leader is obliged to interfere with no delay and to resolve the conflict. Such resolution will take place in private and will be guided to yield benefit both to the audit team and organization being audited.

Finally, the team leader must assure that he and the rest of team members maintain their integrity. They should not only refuse any gratuities to the extent that may jeopardize objectivity but the team leader will take some actions to prevent such situation which might affect further relationship between certification body and audited organization. It is quite frequent that audit team is offered lunch. It is up to team leader to decide whether to accept the offer, but he surely has to clarify the rules by which the lunch may be accepted (regular/ordinary meal, no alcoholic drinks) and to emphasize time limitations conforming the agenda agreed on the introductory meeting.

4.2 Team member conduct

During the conduct of quality audit, team members in the role of auditors principally have access to proprietary information of the audited organization. If not a strictly legal auditors have at least a moral obligation not to divulge this information to third parties. Counter behavior is a breach of this moral obligation having adverse effects on business and professional interests of either organization. The disclosures destroy the trust and gains reputation of being inconducive to build better business relations for certification body and him.

Frequently, in conducting external quality audits, auditors are faced with temptation to discuss another auditing organization performance with the staff of currently auditing organization. This shall be resisted because otherwise, it will produce similar effects to disclosing proprietary information – at least, lack of good taste. It

should be taken into the account, that the approach radically changes when internal quality audits are concerned. If, e.g., the objective of quality audit is to assess quality system efficiency in different facilities of the same company, such discussion would not compromise audit result but could provide some added value for corrective actions.

Auditors should ever have in mind to refrain from making false, unsubstantiated or misleading statements directed to harm or discredit the audited organization's reputation. It is not frequently particularly explicated since it is considered self-evident.

4.3 Technical expert conduct

Like for other team members, in selecting a technical expert significant stress is to be put on ensuring that there is no conflict of interest. The possibility of conflict of interest is even higher comparing with auditor team members since it is common that technical experts come from the same industrial sector as the audited organization and frequently may have associations with the auditees' competitors. Consequently, technical experts are regularly obliged to sign a statement on avoiding conflicts of interest and on ensuring confidentiality once they decide to participate in the audit.

Each technical expert should be assigned to the responsibility of a specific auditor. This means that technical expert should always be accompanied by the auditor, unless otherwise agreed with the customer. In some specific technical clarifications it may be deemed necessary that technical expert directly interviews staff of the auditee. If so, such interviews are to be conducted under the supervision of the auditor who technical expert has been assigned to.

However, audit comments or findings by technical expert should only be communicated via auditor or team leader. Once the auditor needs to findings or comments prepared by technical expert, the

auditor or the team leader may allow technical expert to directly clarify the issue (ISO 9001 – APG).

5. ETHICAL TEMPTATIONS FOR QUALITY MANAGEMENT CERTIFICATION BODIES

The main aim of any certification is to provide confidence to all parties interested in certification. On the other hand, main contributors to build confidence are independence, impartiality and competence both in action and appearance.

Quality management system of a certification body, via organization structure and its procedures should be able to demonstrate how impartiality has been attained on primary level. Besides, certification body should develop policies and procedures and maintain training to successfully cope with pressures and other factors that can compromise or are expected to compromise auditor's objectivity, such tendencies may arise from variety of activities, relationships, and other circumstances or derive from personal qualities and characteristic of auditors that may be a source of bias.

5.1 Auditor impartiality threats

Since threats may reasonably be expected to compromise an auditor's ability to make unbiased audit observations and conclusions, certification body is expected to identify and analyze the effects of threats as a source of potential bias. Threats are assumed in various types of activities or relationships. To understand the very nature of a threat and to assess its potential impact on auditor's impartiality, certification body is obliged to identify types of threats posed by specific activities or relationships. The following list, (ISO/IAF Auditing Practice, 2011) provides typical examples of threats generating pressure that may lead to biased

behavior of the auditor:

- self-interest threats: threats that arise from auditors acting in their own interest. Self-interests include auditors' emotional, financial, or other personal interests. Auditors may favour, consciously or subconsciously, those self-interests over their interest in performing a management system audit. For example, certification body's relationships with clients create a financial self-interest because the clients pay the certification body's fees. Auditors also have a financial self-interest if they own shares in an auditee and may have an emotional or financial self-interest if an employment relationship exists between auditor's family members and an auditee

- self-review threats: threats that arise from auditors reviewing the work done by themselves or by their colleagues. It may be more difficult to evaluate without bias the work of one's own organization than the work of someone else or of some other organization. Therefore, a self-review threat may arise when auditors review judgments and decisions they, or others in their organization, have made

- familiarity (or trust) threats: threats that arise from auditors being influenced by a close relationship with an auditee. Such a threat is present if auditors are not sufficiently skeptical of an auditee's assertions and, as a result, too readily accepts an auditee's viewpoint because of their familiarity with or trust in the auditee. For example, a familiarity threat may arise when an auditor has a particularly close or long-standing personal or professional relationship with an auditee

- intimidation threats: threats that arise from auditors being, or believing that they are being, openly or secretly coerced by auditees or by other interested parties. Such a threat may arise, for example, if an auditor or certification body is threatened with replacement over a disagreement with an auditee's application of a specific requirement of the normative document being used as the reference for the audit

- advocacy threats (e.g. a body or its personnel acting in support of, or in opposition to, a given auditee, which is at the same time its customer, in the resolution of a dispute or litigation)

- competition threats (e.g. between assessed auditee and a contracted technical assessor).

To mitigate or eliminate above listed threats, certification body may use different safeguards they find appropriate and efficient. Such safeguards may include prohibitions, restrictions, policies, rules, institutional arrangements, practices and environmental conditions. This variety of safeguards may be according to where they reside.

First group is made of safeguards that exist in the environment. Examples of such safeguards are accreditation programs for certification bodies that assess compliance with professional standards and regulatory requirements, committees and governance structure concerning impartiality criteria compliance, codes of professional conduct for auditors, raising sanctions for rule breaches, etc.

Second group is constituted by "internal" safeguards, those ones embedded in certification body management system. This includes maintaining a corporate culture in the certification body where the expectation that auditors act in the wider interest is highlighted, establishing policies, procedures and practices within QMS that directly support auditor's impartiality, HR measures that emphasize importance of auditor impartiality and train them in various situations an auditor may face in practice, etc.

Safeguards can be classified according to their nature which also corresponds to problem severity:

- a) Preventive safeguards – e.g. induction program for newly recruited auditors emphasizing impartiality issue, promotion of more stringent policy in that regard;

- b) Safeguards to solve specific threats – e.g. prohibition against certain employment relationship between auditor family members an certification body clients;
- c) Safeguards aimed to deter other safeguards violations by punishing violators – e.g. a code violation having the consequence in serious fall of CB reputation or suspension or withdrawing accreditation results in immediate auditor ousting.

5.2 Impartiality risk assessment

Identification of threats and listing of measures is the first and indispensable step

in coping with quality audit impartiality issue. However, the list of threats and measures is usually very extensive thus requiring, in practice, some priorities be established. Consequently, certification body is to assess the level of impartiality risk taking into account both types/significance of threats to auditor impartiality and types/effectiveness of safeguards employed. Virtually, certification body should describe a process by which it identifies and assesses the level of impartiality risk that arises from various activities and relationships. The level of impartiality risk is frequently expressed via segments in impartiality risk continuum as the likelihood of compromised objectivity, presented in Table 1.

Table 1 - Level of impartiality risk

No risk	Remote risk	Some risk	High risk	Maximum risk
Compromised objectivity is virtually impossible	Compromised objectivity is very unlikely	Compromised objectivity is possible	Compromised objectivity is probable	Compromised objectivity is virtually certain

Certification body should determine whether the level of impartiality risk is at an acceptable position on the impartiality risk continuum. Certification body is to evaluate the acceptability of the level of impartiality risk that arises from specific activities and relationships. That evaluation requires them to judge whether safeguards eliminate or adequately mitigate threats to auditor impartiality posed by those activities, relationships, or other circumstances. If it is not a case, it is advisable to decide which additional safeguard (including prohibition) or combination thereof would diminish the risk, and the corresponding probability of compromised objectivity, to an acceptably low level.

Certain factors in the environment in which audits take place — for example, that the auditor is given gratuity to spend seven days in company’s resort on the seaside with

significant price discount — the impartiality risk cannot be completely eliminated and, therefore, certification bodies regularly accept some risk that auditors' objectivity will be compromised. Nevertheless, in the presence of threats to auditor impartiality, certification should regard only a very low level of risk to be acceptable. Only such a small likelihood of compromised objectivity may be regarded aligned with both the definition and the goal of auditor impartiality.

Some threats to auditor impartiality may affect only certain individuals or groups within a certification body, and the significance of some threats may be different for different individuals or groups. To ensure that the risk is at an acceptably low level, certification body is to identify the individuals or groups affected by threats to impartiality and the significance of those

threats.

Certification body is supposed ensure that the benefits resulting from reducing the impartiality risk by imposing additional safeguards exceed the costs of those safeguards. Although benefits and costs are often difficult to identify and quantify, certification body should consider them when they make decisions about auditor impartiality issues.

6. CONCLUDING REMARKS

Although majority of quality related issues are nowadays covered by international standards which contain quite explicit requirements (thus providing possibility to easily assess whether someone is compliant with what he is supposed to), such statement can't be extrapolated to the field of quality

audit ethics. One of major reasons lies in the fact that business environment is extremely dynamic and business customs vary from nation to nation. On one hand, ethical matrices are nationally different, and on the other, impartiality threats take very specific and sometimes unexpected shapes. Since standardization process require a stabilized repetitiveness of the object of standardization for a certain time period, it is not possible to standardize effective responses to ever-changing pressures that are exerted on quality auditors.

Standards and guidelines regarding quality audit ethics are very helpful to quality auditors in setting principles on how to cope with ethical temptation. However, it is up to the certification body to define own Code of Ethics that will diminish threats to the level defined in the organization policy.

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