Financial crises uncover existing frauds and tempt businessmen fighting for economic survival to perpetrate new ones. The current crisis and ensuing recession are no different, with the high-profile arrest of Bernard Madoff, charged with running a $50bn (£36bn) Ponzi scheme, and the exposure of Sir Allen Stanford’s alleged $8bn fraud involving certificates of deposit. Even venerable old English cricket – which spawned the phrase ‘it’s not cricket’, to refer to unethical behaviour – has been dragged through the mire because of Stanford’s sponsorship of the game.

Politicians and the media, meanwhile, are pointing the finger of blame at everyone from unfit government to greedy bankers, and calls are growing for a more ethical form of capitalism. The challenge for the accountancy profession is to help turn these demands into verifiable business practices.

WOOLF AT THE DOOR

BAE Systems responded to allegations of bribery and corruption in the award of defence contracts by appointing Lord Woolf, the former lord chief justice, to chair an independent committee to scrutinise its ethical standards. Among Woolf’s 23 recommendations made last year, which BAE committed to implement before publication, was a call for independent assurance of BAE’s ethical behaviour. Given that such assurance is in its infancy and there are no generally agreed frameworks or business practices to follow, BAE’s action has placed it at the leading edge.

Ethical assurance is not mandatory, so companies like BAE, which have reputational issues that need addressing, will drive the impetus for implementation. ‘They will be the catalysts, breaking new ground for others to follow,’ says Kirsty Searles, a specialist internal controls partner at Deloitte, which has been engaged to conduct BAE’s first external ethical assurance project in 2009.

FROM PROMISE TO PRACTICE

But what will ethical assurance mean in practice? The ICAEW’s ethics team has highlighted four key challenges in turning an ethical commitment into a working methodology.

The first challenge is to define assurance. ‘Lack of understanding may create an expectation gap between providers and users of assurance services,’ says Anne Davis, ICAEW ethics manager. ‘Some people confuse assurance with insurance, which is a source of recourse when something goes wrong with the business. This is not the case. Assurance is about adding credibility by providing an opinion on certain information.’

Measurement is the second challenge. Providers of assurance may be experienced in auditing quantitative information, but ethics is a more subjective area and it may be difficult to identify suitable criteria and evidence on which to base an assurance opinion. ‘Even if controls and procedures can be verified and measured, this may not be enough. Ethics is ultimately about individual behaviour,’ adds Davis. ‘Assessing and measuring individuals’ ethical standards of behaviour as part of the assurance process is likely to be an onerous task.’

Third, is the lack of agreed standards or frameworks...
for ethical assurance. Currently, the only internationally recognised standard is the International Auditing and Assurance Standards Board’s International Standard on Assurance Engagements 3000. ‘With ethical assurance it has been left to individual practitioners to tailor the high level principles of ISAE 3000 to suit the needs of individual clients,’ explains Jo Iwasaki of the ICAEW Audit and Assurance Faculty.

Practical help, however, is available. As part of its Re: Assurance initiative, the institute has issued two publications for practitioners, which offer guidance on the requirements of ISAE 3000 and explore different areas of non-financial assurance work, such as corporate responsibility.

BAE has asked Deloitte to work in accordance with ISAE 3000 in preparing both corporate responsibility reports and a statement on its implementation of the Woolf recommendations. ‘ISAE 3000 is a broad guideline, but we have asked Deloitte to assure the Woolf implementation work to the highest current standard of assurance under ISAE 3000, which is ‘reasonable assurance’’, says Nick Hubbard, programme director for Woolf Report implementation at BAE.

Other frameworks are also under development. For example, a working group formed by Transparency International and the World Economic Forum’s Partnering Against Corruption Initiative, with participation from the Big Six accounting firms, will shortly publish a model for consultation, which sets out a framework for providing assurance over corporate anti-bribery systems.

SPREADING THE WORD
The final challenge according to Davis is reporting: establishing how information on ethical standards should be reported and to whom. ‘Businesses must strike a balance between providing a vast amount of information because it falls under ethical assurance, and not producing enough to adequately address stakeholders’ concerns,’ she says.

Businesses must also decide whether to report internally or externally. Demand for internal assurance, presented to the board, audit or corporate responsibility committee, is likely to develop ahead of ethical assurance published externally, as many companies will want to assess their ethical procedures before exposing them to wider scrutiny.

Searles at Deloitte identifies two forms that a publicly reported ethical assurance opinion could take. The first is an assessment that would provide an opinion on whether the controls put in place are appropriately structured to achieve the desired objectives. The second is an opinion on the effectiveness of those controls, where the assurance provider would attest not just to the existence of controls but also that they work in practice.

Controls that test effectiveness already exist in other areas of assurance, but in the new field of ethics Searles admits, ‘realistically they are still some way off and will emerge gradually’. In the short term, she expects Deloitte’s audit to result in a narrative report on BAE’s progress in implementing Woolf’s recommendations.

The work BAE Systems is carrying out in response to Woolf will be conducted over a three-year period. The initial phases will determine the actions to be taken and Deloitte’s work for BAE to date has focused on the team responsible for undertaking this work.

As the implementation programme progresses over 2009-2011, the nature of the work will change as the agreed actions are rolled out and embedded into how BAE conducts its day-to-day business. ‘The focus of Deloitte’s work will change accordingly,’ says Hubbard. ‘It will be directed to our business operations in order to provide an assurance report that the actions have been understood and fully embedded across the organisation.’

MEETING THE CHALLENGE
The groundswell of opinion for higher ethical standards has strengthened an existing trend towards greater scrutiny of business conduct resulting from earlier corporate scandals. And stakeholders increasingly want to ensure that the information they make publicly available is credible and fit for purpose.

Assurance on non-financial information is a new frontier that raises a number of practical difficulties. But the ICAEW believes that these obstacles are not insurmountable. The Woolf report and Deloitte’s work with BAE should help open a door to showing how ethics can be at the heart of business.

But at the very least, arrangements which blatantly discourage ethical behaviour should come under increased scrutiny from businesses, regulators and governments.

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