

# Evaluation of how professional and business ethics are applied in practice by accounting firms

Report to the Financial Reporting Council

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As directed by the FRC, none of our findings are firm-specific and none of the information we have referred to in this report is attributed.

*Ethics is less tangible than independence.*

*FRC Review Participant (2007)*

*Independence has been done to death.*

*FRC Review Participant (2007)*

*Brand and reputation are the bigger drivers for ethical practice. Independence compliance is the easier thing to deal with as you can bring in systems and training to deal with it. But more fundamental is to make sure our Partners and Directors do the right thing and do not walk past the scene of the train accident.*

*FRC Review Participant (2007)*

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## Executive Summary

The Financial Reporting Council (FRC) commissioned Banarra in May 2007 to review ethics in practice in seven accounting firms. As a result of our three stage methodology (see Appendix A) we arrived at these general findings:

- Ethical practices are highly valued (see 2.1); especially in the context of the firms' demonstrated understanding that unethical practices damage their reputations and brands (see 2.2);
- Organisational values are articulated by all the firms. As a result of this values-based building of culture and the other evidence collected we are able to conclude that the firms are focused on actioning preferred behaviours and these include ethical behaviours (see 2.3);
- Size does not matter as there were no clear significant differences between the Big 4 and the significant other firms reviewed, but there were differences between individual firms (see 2.4);
- The profession has leading ethical practices (see 2.5);
- Significant resources are being invested by the firms to ensure compliance with independence and quality requirements, however ethics in practice is more than independence (see 2.6);
- Some firms' risk management functions are not working as closely with HR as they could to fully leverage the HR data contained in employee-surveying mechanisms to understand the firm's ethical cultural health. (see 2.7);
- The tension between a principles-based versus rules-based approach to encouraging ethical behaviour continues (see 2.8); and
- The FRC's ethical supervisory responsibilities are seen by the firms as limited to independence and our broader scope created concern from some review participants, who saw this as the FRC overreaching its responsibilities in relation to ethics. All of the firms cooperated and most welcomed the opportunity presented by the review. (see 2.9).

Key issue-specific findings included:

- Most firms have mechanisms such as employee surveys which are monitoring cultural health through specific questions (see 3.1);
- Firms are declining work with decisions where ethics is a factor (see 3.2);

- Approaches to whistleblower mechanisms are different. Small numbers of cases have been recorded. Those firms asserted that the numbers are low because ethical practice is very strong within the firm. This uses the number of cases as a lag indicator of strong ethical practice; a valid function for the indicator once widespread confidence in the mechanism can be demonstrated (see 3.3);
- Leading firms have embedded into their performance management processes explicit expectations in relation to ethical behaviour, such as acting with integrity and in some cases this is being tied to remuneration. There are clear sanctions in all firms for those who behave unethically and there is evidence that these sanctions are applied (see 3.4);
- The monitoring of ethical training is primarily focused on 'outputs', for example the number of people who complete the training rather than also considering 'outcomes' as in the effectiveness of the training (see 3.5); and
- There is significant difference between firms in terms of how they use symptomatic or "lead" indicators, such as the results of employee surveys and diversity performance, as indicators of cultural health with some firms well developed in this area (see 3.6).

Key recommendations from the review include:

- Encouraging the professional bodies and perhaps the Accounting Professional and Ethical Standards Board (APESB) to consider establishing a mechanism that facilitates the sharing, reviewing and critiquing of leading ethical practices. This would demonstrate the commitment of the profession to ensuring that, as a whole, it is driving the highest ethical standards.
- Extending the profession's approach to ethical measurement from lag indicators and outputs to lead indicators and outcomes. This could be achieved by:
  - the firms and professional bodies identifying a core set of lead and symptomatic indicators for cultural health and ethics in practice;
  - the FRC making greater use of lead and symptomatic indicators in delivering its supervisory responsibilities; and
  - the firms reviewing their approach to evaluating ethics training with a view to extending from measuring outputs to also include outcomes.
- Recommending that clients request lead and symptomatic indicators from those firms they are considering appointing.

Other stakeholders of the profession could also request that this information be publicly available so they can draw their own conclusions on ethical performance.

- The FRC needs to overcome the current equating by the firms of a “supervisory role” with independence compliance if it is to have an accepted role in ethics in practice beyond independence.
- Greater leadership by the FRC by both facilitating and participating in the debate on the dynamic and evolving tensions between a principles-based and rules-based approach to encouraging ethical behaviour within the profession.

## 1. Introduction

The FRC previously commissioned a review of the teaching in ethics in the accountancy profession in 2006. The high level findings of this work were made publicly available in the FRC 'Report on Auditor Independence 2005-06'. A key finding in terms of ethics in practice from the review was that:

*...the depth of understanding of ethical issues of officers of the three professional accounting bodies and of members of accounting firms, their commitment to deal with these issues and steps being taken to do so, is well beyond anything observed in other disciplines, business or professions, including law; (P.47, FRC Report on Auditor Independence 2005-06)*

Both this previous work and Banarra's are based on Section 225 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) <sup>1</sup> which states that a function of the FRC is:

*...promoting, and monitoring the adequacy of, the teaching of professional and business ethics by, or on behalf of, professional accounting bodies to the extent to which the teaching of those subjects relates to auditor independence.*

In a second letter to the firms participating in this review (see Appendix F) Charles Macek wrote that it is the "FRC's view that a proper assessment of the adequacy of the teaching of professional and business ethics requires some research on how this teaching translates into actual ethical behaviour at the firms".

Our approach, considering both broader ethics in practice areas and symptomatic indicators, allows us to assess "adequacy" by coming to a view on the outcome. That is the strength of the cultures that support ethical behaviours in practice. It is this view upon which our methodology and review scope are based. We discussed further below the tension between the review's scope and the FRC's explicit functions.

### **1.1. Objectives and Methodology**

The objective of the review was to evaluate how professional and business ethics are applied in practice by accounting firms.

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[http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/ABBF954328819381CA257344002246F6/\\$file/AusSecInvCom2001\\_WD02.doc](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/ABBF954328819381CA257344002246F6/$file/AusSecInvCom2001_WD02.doc) accessed 29 August 2007

Our Statement of Work (see Appendix B) also required that we would consider:

- (a) the extent to which the accounting firms ensure their partners and staff are aware of, and comply with, the ethical requirements of the professional accounting bodies;
- (b) whether the accounting firms have their own ethical requirements which supplement those of the professional bodies and, where they do, the extent to which partners and staff comply with them;
- (c) whether accounting firms take disciplinary or other action against partners or staff who fail to comply with the ethical requirements of either their professional body or the firm;
- (d) whether firms reward partners and staff for maintaining high ethical standards, even in circumstances where there is a resultant financial loss to the firm; and
- (e) any observations, findings or recommendations made by the consultant who reviewed the teaching of professional and business ethics by, or on behalf of, the professional accounting bodies about the manner in which professional and business ethics are applied in practice by accounting firms.

The Statement of Work specifically stated that our work should not be limited to its specific objectives. We believed that merely confining our review to what the Statement of Work specifically required of us would limit our ability to come to a broader view of business ethics in practice. Consequently, we proposed a broader review based upon the application of our methodology and this approach was accepted by the FRC (see Appendix A).

Our review findings are the results of a three stage methodology. Stage 1 involved desktop research on ethics in practice in the profession globally as well as interviews with 15 key informants. Analysis of the research resulted in the identification of key material performance areas and issues in terms of ethics in practice in the accountancy profession. These material issues were used in Stage 2 as testing subject matter against which we collected evidence through document review and over 25 interviews in the seven firms. In Stage 3, the qualitative information gathered was analysed resulting in our findings and recommendations.

Banarra, based upon our Stage 1 research, concluded that strong ethical practice is a function of ethical cultural robustness. To deliver upon the scope of work of evaluating professional and business ethics

in practice in the accountancy firms, we have focused upon how the firms have built, changed, maintained and monitored their cultures. As a result of the review we have come to understand the strength of a firm's culture as a strong 'lead' indicator of good ethical practice. In contrast a 'lag' indicator approach would look at metrics such as whistleblower cases and incidents of serious non-compliances.

In reviewing the subject matter areas, we attempted to approach them in a way that was different from other previous supervisory activities, such as ASIC's.

## 1.2. Professional ethics vs. business ethics

In referring to “professional and business ethics” without limiting it to auditor independence this review’s Statement of Work takes a broader view of ethics in practice.

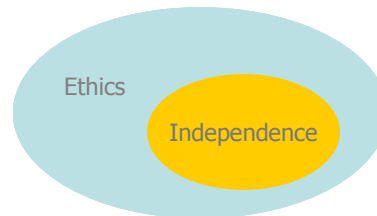
From the responses to our initial approaches to the firms we concluded that, for some, ethics in practice in the context of a FRC review should only be about how the firm responds to the issue of independence. Other firms fully embraced a broader definition of ethics, recognising that poor ethical performance in any area of their business is likely to affect their reputation along with that of the wider accounting profession.

This variation may be driven in part by what appeared to be differing interpretations of ‘ethics’ and ‘independence’ – our initial understanding following conversations with the accounting firms can be summarised as:

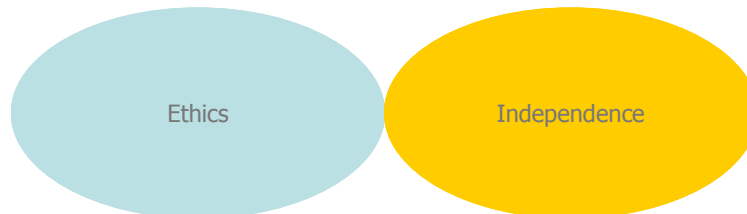
Ethics is Independence



Independence is a subset of Ethics



Ethics and Independence are separate



The focus on independence (conflict of interest) and associated compliance requirements appears to have absorbed considerable resources and conceptual space in relation to ethics in practice. This response is driven by a strong commitment within the firms to meet their statutory and regulatory obligations. The primary focus on independence may have narrowed some firms' appreciation of what constitutes broader business ethical performance. As a result it may be that the increasing codification and compliance focus on one or two key aspects of ethical behaviour may be in fact eroding or preventing a more holistic approach to enabling ethics in practice.

While independence conflicts are the most material form of unethical conduct that confronts the firms, it has been substantially responded to by both the profession and the regulators.

The profession attracts significant public interest when there are perceived or real unethical practices such as a series of cases related to aggressive tax advice in the US. These types of cases can present a risk to the firm's reputation. It is this context that provides additional rationale for the FRC to ask how effective is the teaching of ethics in delivering practice beyond independence.

## 2. General Findings

### 2.1. ***Ethical practices are highly valued***

Ethical practices are highly valued within the profession. This situation has driven a values-based approach to encourage required people behaviours. These required behaviours, arising out of the firms' values, include core ethical values such as integrity.

Our conclusions have considered the results of the ASIC and AQRB reviews of both independence and quality practices and their impact on ethics in practice. As previously mentioned, our review did not consider in detail the independence practices addressed within the previous reviews of individual firms by ASIC and AQRB.

### 2.2. ***Unethical practices damaging reputation keenly understood***

Regulation has driven significant investment in systems and processes to ensure compliance with independence requirements, however it may be the protection of brand and reputation that is just as strong if not a stronger driver of delivering ethical in practice across the firms. We found a keen understanding within the firms of the importance and value of reputation, with the speed of the Andersen demise being the illustration most commonly offered to Banarra.

### 2.3. ***Ethical behaviours are actioned in practice***

Ethics in practice is actioned. We believe the actioning of ethics is as strong as it is because of the significant focus on both articulating and embedding values into the firms. This values-based approach is being actively used to both build and change culture and behaviour within most of the firms.

### 2.4. ***Size doesn't matter***

We cannot arrive at clear conclusions in terms of differences in ethics practice between the Big 4 and the significant other firms. However, there were clear differences in practice between individual firms. Our conclusion here is primarily focused on the approach to actioning ethics in practice rather than performance.

### 2.5. ***Profession has leading ethical practice***

Amongst the firms we reviewed, we identified what may be considered leading practices both within the profession and across sectors. These practices include:

- Monitoring ethical cultural health through employee surveying;
- Conducting stand alone ethics surveys;
- Reinforcing values in all training sessions – no matter what the subject matter;
- Using the results of employee feedback processes as input into behaviour measurements for remuneration;
- Use of workshops where participants work through ethical dilemmas;
- Preventing or deferring promotion if an employee’s ethical performance is regarded weak (even when their business or sales performance is high); and
- Screening potential employees specifically on their response to ethical dilemmas.

## **2.6. *Ethics is more than independence***

Significant resources are being deployed to respond to the regulatory requirements in relation to independence. For stakeholders of the profession there is a key question that needs to be asked in terms of when the regulatory focus on independence is sufficient and firms should be encouraged to take a broader view of deploying resources to ensure consistent ethics in practice beyond independence.

In addition, we understand that there are a range of other regulations and regimes that impose their own ethical requirements upon the firms such as APRA and anti money laundering regulations. We have not specifically reviewed the ethical requirements of these other processes.

## **2.7. *Risk management not fully leveraging HR data***

There were opportunities identified in most firms for better integrating responsibility for managing the risks associated with the wider business ethics in practice with the human resources function. For example, in some firms there is the opportunity to more systematically use staff survey data to better understand cultural health.

## **2.8. *Tension between principles & rules continues***

There is a well articulated tension within the profession between taking a rules-based approach to delivering the appropriate behaviours and taking a principles-based approach.

Through our key informants (Appendix C), it was identified that there is a key difference in the emphasis in this area between the United Kingdom and the United States, with considerable public leadership in

the United Kingdom provided by the professional bodies and the supervisory bodies for a primarily principles-based approach. In the United States, while the emphasis has been on rules, it was noted that the SEC has considered the balance between principles and rules, having commissioned a relevant study.

## **2.9. *FRC's ethical responsibilities seen as limited to independence***

The FRC's responsibilities in relation to ethics in practice are seen as confined to auditor independence and the teaching of ethics because this is "black letter" of the FRC's scope. This focus is further reflected in the structure and labels used by the FRC including its Auditor Independence committee which commissioned this review.

Our statement of work included a significantly broader scope in that we were asked to look at the broader issues of business ethics in practice within firms. It was this broader scope that created concern from some review participants, who saw this as the FRC overreaching its responsibilities in relation to ethics. Other participants saw this as an opportunity.

### 3. Issue Specific Findings

Using NVivo qualitative research software, Banarra collated the issues identified from the above four avenues of research into a Materiality Register. The IFAC *Code of Ethics for Professional Accountants* was used as the initial framework for identifying relevant issues; however other issues relating to ethical performance were also identified during the desk research - primarily around ethical culture and practical responses to ethical challenges.

Forty performance areas and issues were ranked as the most important or material issues (see Appendix D for Register sample with the top 15) and of these six were selected for direct testing with the seven firms. The findings in these six areas are addressed below.

#### 3.1. ***Tone at the top & tone throughout***

Leadership and the tone set at the top in relation to ethics were recognised by all the firms as critical to encouraging ethical behaviour. Our Stage 1 research also identified that tone throughout the organisation is important for ensuring ethical behaviour in all parts of the organisation.

All of the firms reviewed had formally articulated their organisational values. In every case these included at least one of the IFAC ethics framework principles. Generally they included either integrity or honesty – in some cases both.

Most of the firms were able to articulate both a conceptual and formal approach to ensuring that values were translated into preferred behaviours. Where this was the case, the most significant amongst these preferred behaviours were ethical behaviours. These most often related to the expected integrity behaviours. For example, “We act with integrity = being recognized in the marketplace as the organization with the strongest professional reputation”.

##### 3.1.1. **Measuring and monitoring tone throughout**

We asked all the firms how they measured and monitored tone throughout. The most widely used formal approach was through employee surveys. There was a variety in methodologies, providers and frequencies employed by the seven firms. The approach to staff surveys varied from annual employee surveys with regular ‘pulse surveys’ and stand alone ethics surveys to irregular staff surveys.

Within the employee surveys we observed a range of questions that provided an indication of the employee’s views of how robust ethical practice was within the firm. These included questions such as “Partners demonstrate the firm’s values in their every day behaviours” and “We always do the right things even if it means losing the client.”

A number of the firms provided the results to the integrity questions. The results we were able to sight were positive.

Most of the firms' risk management areas appeared to make little formal, systemic or proactive use of these results. Generally the risk area relied on the HR area to raise issues rather than combined review and analysis of the results. There may be opportunities for greater combined analysis of these results.

Other mechanisms used to monitor tone throughout included systemic use of 360° and upward feedback mechanisms that included specific questions on ethical behaviour; focus groups; advisory panels of employees and annual declarations on conformance with codes of conduct.

We noted that there were differences within the various approaches listed above between the firms. For example, with the annual declarations some firms explicitly seek confirmation in relation to ethical practice, while with others it is implicitly included in the declaration that there is compliance with all the firm's policies including those related to ethical practice.

We noted that there are intentions of some firms to strengthen this area of practice in relation to ethics. For example one firm stated that they were intending to implement an annual declaration process that specifically included reference to address specific areas of ethical behaviour.

The leadership dimension was recognised in all firms as critical and the leading practice firms were measuring leadership's demonstration of ethical practice through the use of mechanisms such as upward and 360° feedback.

We were presented with a number of cases across the firms where partners were dismissed and disciplined for improper conduct. The cases were most often in relation to inappropriate behaviour towards staff.

Employees are a key stakeholder in relation to ethics in practice. There are however, a range of other stakeholders whose views can also be solicited. We were only able to identify one firm that uses client satisfaction surveying to explicitly solicit feedback on ethical performance. However, all those that we questioned stated that their client feedback contained open questions through which they expected clients to raise issues in relation to the firm's ethical performance.

### **3.1.2. New hires and ethical practice**

The hiring process is another significant opportunity to build and strengthen the organisation's culture. Some firms clearly articulated

the new hire process as an opportunity to ensure a “values fit” with the firm as this increases likelihood of making “ethical hires”. Some firms did include specific testing of potential ethical behaviour in response to dilemmas posed during the interview process.

The approach taken to inducting new recruits is also key, particularly following mergers and acquisitions. For most firms the induction training includes specific ethical or values dimensions.

### **3.2. Working through tensions & declining work**

There are related aspects to this issue such as addressing tensions between firm financial gain and public interest; tensions between client and public interests; tensions between the letter and spirit of the law.

The leading practitioners articulated protection of the brand and reputation as core to informing decisions about where tensions arise. Where there are dilemmas or tensions, the route taken is one that would be one that would more likely protect the firm’s brand and reputation.

#### **3.2.1. Declining work on ethical grounds**

We found that potential clients are being declined on broader ethical grounds. The decisions are primarily made on a case-by-case basis rather than blanket sector bans. Some firms have had sector exclusion policies - these related to internet gambling and prostitution. In relation to internet gambling, the exclusion has now been lifted. There was acceptance of the right of individual employees to decline to work for particular clients in some firms, although this was not sighted as a formal policy.

Unethical clients are seen by all firms as higher risk clients. This is both from a straightforward financial perspective as well as from brand and reputation perspective. As higher risk clients, they are more likely to be declined. An example of refusing a potential client in the tax advice area was given by two of the firms, where the intent of the client was to obtain advice about tax avoidance rather than minimisation. Both firms declined their respective potential clients seeking this advice.

All firms have a formal approach to client acceptance and continuance which is primarily delivered through checklist and review processes. An integrity check is required by all these processes, although we noted differences in the methodologies used. We also noted that none of the checklists we sighted included requesting the types of “lead” indicators Banarra has referred to in this report.

In terms of transparency, there is no publicly available reporting from the firms in terms of the number, value and reasons for declining work where there are ethical conflicts. We make this observation because we have noted in other sectors that a small number of leading organisations do provide this type of information. For example, the Co-operative Bank in the UK reports on clients refused because they fail to meet the bank's ethical lending policies.

We acknowledge that in many cases, prospective clients are declined very early in the process and before they are captured in any internal system.

If the importance of brand and reputation continues to increase in the profession, Banarra's expectation is that the firms will undertake more proactive stakeholder engagement to identify emerging issues and performance areas that pose a risk to their brands. As a result of this engagement, we would expect even more informed and complex decision-making in relation to client continuance and acceptance.

### **3.2.2. Working through tensions**

There was a mix of approaches to supporting partners and employees in resolving the tensions that the firms can confront in their work. Again the emergence of protection of brand and reputation as a driver appeared when we explored this area. The range of responses to these tensions was from informal understanding as to which Partners would be consulted to formally appointed and identified individuals, with titles such as ethics officers, who were available for those who were confronted with a "grey" or dilemma ethics issue.

Cases were shared with Banarra that demonstrated these mechanisms are used in practice by individuals within the firms when having to respond to the types of tensions identified.

### **3.3. Encouraging issue raising & protecting whistleblowers**

There were different approaches to establishing whistleblower mechanisms across the firms. For those firms with established processes some had implemented it in the last couple of years, while others had done so over five years ago.

Most firms encourage the use of various channels to raise issues, with the first step being to raise issues with the direct manager.

Of the firms with stand-alone, whistleblowing mechanisms, all have recorded a small number of cases. Those firms asserted that the numbers are low because ethical practice is very strong within the firm. This uses the number of cases as a lag indicator of strong ethical

practice; a valid function for the indicator once widespread confidence in the mechanism can be demonstrated.

We were unable to sight completed measurements of 'trust' in the mechanisms. Some firms are committed to exploring the issue through surveying.

In terms of general issue raising, some of the firms' employee surveys already ask whether "it is safe to speak up at (firm)" and the results we viewed suggested that, while it is a small number, there are employees who either feel unable to answer affirmatively as they have not yet had cause to speak up or do not believe it is safe to speak up.

In practice, we understand that reporting issues to partners can be daunting for more junior employees, in the context of partners also being owners of the business.

Some of the firm's policies expressly prohibit retaliation against anyone who reports a violation and the policies commit to taking disciplinary action against any firm employee who does.

The firms recognised that whistleblowers can be either employees or external to the firm. For most firms, their promotion of whistleblowing mechanisms has been largely internal. There were some firms that had proactively communicated their whistleblowing mechanisms publicly.

Whistleblower cases are a key lag indicator in terms of ethics in practice and an organisation's cultural health.

### **3.4. *Managing ethical practice***

The following section brings together the reward and discipline testing area and an aspect of managing tone at the top - the use of performance management to action ethical behaviour.

#### **3.4.1. Performance management & ethical practice**

Leading practice within the firms saw organisational values translated into expected behaviours and these in turn appeared in performance management processes. In a number of firms the expected behaviours were measured using either upward feedback or 360° feedback processes. Measurement of key behaviours, such as acting with integrity, appeared in the processes we sighted.

We sighted a number of processes that generated metrics from behaviour measurement that become a factor in calculating bonuses. In the firms where this values-based approach was linked to performance management, it provided Banarra with confidence that

the organisation was committed to ensuring ethical behaviour in key areas, such as integrity.

While some firms do make a very direct and explicit relationship between ethical behaviour and remuneration, the weighting given to the behavioural dimension differs between those firms that take this approach.

#### **3.4.2. Discipline and ethical practice**

The approaches to discipline in the event of unethical behaviour were very similar between the firms with clearly and formally articulated penalties for unethical behaviour.

Those with formal processes could provide cases, including for partners, where penalties were applied.

Discipline and consequences if employees act unethically are formal, structured and communicated.

There was little formal communication of disciplinary actions internally and Banarra recognises that there is a tension between demonstrating that there are consequences with respecting the dignity of the individuals involved and not moving towards a public shaming of those individuals.

#### **3.4.3. Reward and ethical practice**

Other than through remuneration and promotion (as discussed above) the approaches to rewarding ethical behaviour were less formal and structured than the approaches to discipline. On a number of occasions it was asserted that ethical behaviour is the expected 'business as usual' behaviour within the firm and so it should not be formally rewarded.

For those firms with formal staff performance recognition programs, we identified some awards or recognitions that could be considered as recognising and rewarding broader ethical behaviour.

### **3.5. *Effectiveness of ethical training***

Effectiveness of training is largely approached through measuring 'outputs' – that is the number of people participating in ethics training – rather than 'outcomes'. There were examples of testing knowledge at the end of training; however we were unable to identify efforts to understand the outcomes of ethical training.

### **3.6. Symptomatic and lead indicators**

Some firms were making significant use of symptomatic indicators to understand the strength of culture. They were essentially using them as lead indicators of ethical practice in the same way that say a mining company uses 'potentially fatal near misses' as a reflection of the robustness of their safety culture rather than the 'lost time injury frequency rate'. There were essentially two types of indicators, the perceptual results from ethics in practice related questions in the employee surveys and the quantitative results from workforce diversity and health measures.

It may be possible for the profession to aggregate a set of relevant employee survey questions to produce the equivalent of an employee engagement score for ethical cultural health. The potential questions that might be included in such a measure, already in use within the profession, are;

- Is it safe to speak up in my workplace?
- Do Partners demonstrate the firm's values in their every day behaviours?
- Do my work colleagues demonstrate the firm's values in their every day behaviours?
- Do we always do the right things even if it means losing the client?
- Does the level of stress in my job seriously reduce my effectiveness?

Banarra reviewed three of what might be considered quantitative indicators identified during our Stage 1 research. These were:

- diversity from both a gender; and ethnic perspective;
- work life balance; and
- rates of depression.

Related to these areas was our examination of whether the firms engaged in public reporting and whether the firms offered advice services or had engaged in public education in relation to ethics in practice.

Some firms recognised the value in using symptomatic indicators to understand cultural strength in relation to ethics and were measuring areas such as acting with integrity, work life balance and diversity.

None of the reviewed firms had a process for monitoring or recording incidences of stress/depression, but employee assistance programs were offered by the majority of firms. These services were provided by external providers.

Despite numerous initiatives, of the results we viewed, employee perception as measured through staff surveys of work life balance and stress suggested that this area remains challenging.

While there was growing internal use of symptomatic indicators, there was no evidence of public commitments to transparency and accountability through public reporting of these indicators with Australian firms.

What we did identify was where their related firms in other territories were producing public reports that contained the type of indicators that provide an indication of cultural health and ethics in practice. The two identified examples were published by PwC in the Netherlands and Deloitte in South Africa. The PwC Netherlands report includes data on breaches of the code of conduct by employees, including resulting dismissals. The Deloitte South Africa report includes data on gender and ethnic diversity, including the number of female partners.

We also noted in our Stage 1 research that the role of culture is widely accepted in ensuring appropriate behaviours and that measuring cultural health can serve as lead indicator.

In 2005, at a BP refinery in Texas, 15 people were killed in a safety incident. BP's own investigation concluded that poor culture was a significant contributor and particularly the breakdown in trust between employees and management. The *Fatal Accident Investigation Report Isomerization Unit Explosion Final Report* noted:

*The last independent survey of the workforce produced bottom quartile People Assurance Survey (PAS) scores for the site, further emphasizing the low morale and distrust of site leadership.<sup>2</sup>*

The report also went on to note the importance of using lead indicators in a health and safety context:

*The Texas City site has numerous measures for tracking various types of operational, commercial, environmental, and safety performance. These Key Performance Indicators (KPIs) were not prioritized, and did not clearly focus on the leading indicators that would provide early warning of potential catastrophic and major incidents, nor were the important ones visible or obviously tracked.*

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<sup>2</sup>[http://www.bp.com/liveassets/bp\\_internet/us/bp\\_us\\_english/STAGING/local\\_assets/downloads/t/final\\_report.pdf](http://www.bp.com/liveassets/bp_internet/us/bp_us_english/STAGING/local_assets/downloads/t/final_report.pdf) page 164

### **3.6.1. External research and promotion of ethics**

We identified a number of firms who had conducted research, produced publications and provided services that directly addressed ethics in practice within client and potential client organisations.

We did not observe any firms including themselves in the research, or applying the findings, or using their own external services internally on themselves. However, one firm has made a commitment to applying its external ethics-related diagnostic tool to itself.

## 4. Recommendations for the Financial Reporting Council

As a result of our review a number of overarching questions arose which we present below with potential responses.

### 4.1. ***Leading ethical practices - proprietary or common goods?***

Amongst the firms we reviewed, we identified examples of what may be leading ethical practices both within the profession and across sectors. Currently, there appear to be few mechanisms for the leading practice to be shared between firms. Banarra suggests that ethical practices and learning within the profession should be freely shared as the whole profession has a significant stake in continuing to be seen as ethical.

Banarra does not believe additional ethical standards are currently required, instead there is a potential to improve ethical practice across the profession if the current leading practice is shared, reviewed and critiqued between peers.

#### 4.1.1. **Leading ethical practices recommendation**

The professional bodies, the APESB and/or the firms themselves could consider establishing a mechanism that facilitates the sharing, reviewing and critiquing of leading ethical practices.

### 4.2. ***Extending from lag indicators and outputs to include lead indicators and outcomes?***

To effectively monitor and supervise firms and be assured of the best ethical practice, the focus needs to also include lead indicators and outcomes. To review the number of cases of discipline, whistleblower reports or non-compliances with a code of ethics is the ethical practice equivalent of visiting the scene of an accident after it has happened.

A variety of methods are already employed by the firms to collect data that provides the basis of compiling lead and symptomatic indicators of a firm's cultural health. These vary from annual employee surveys with regular 'pulse surveys', to stand-alone ethics surveys. However, more can be done to leverage this data.

A similar observation was made in relation to ethical training. Banarra noted significant efforts undertaken by the firms to deliver the training, yet the monitoring is an 'outputs' exercise rather than explicitly understanding 'outcomes'. It is the number of people who have completed e-learning module that is being recorded rather than

exploring ways of understanding the impact of the learning upon the participant.

#### **4.2.1. Lead indicators and outcomes recommendations**

The firms and professional bodies could consider identifying a core set of lead and symptomatic indicators, based upon the leading practice already in place in some firms, that can work as a comparable proxy for cultural health and ethics in practice across the profession.

The FRC could consider the greater use of lead and symptomatic indicators of cultural health and ethics in practice in delivering its supervisory responsibilities.

The firms could review their approach to evaluating ethics training with a view to extending from measuring outputs (that is the number of employees who have completed them) to also include outcomes.

### **4.3. A more transparent profession?**

There appears little current appetite for the mandating of public reporting in relation to the wider non-financial performance aspects of Australian businesses. Two recent enquires - the Parliamentary Joint Committee on Corporations and Financial Services Inquiry in Corporate Responsibility and CAMAC - both concluded that sustainability reporting or wider performance reporting should remain voluntary.

However, a profession-wide approach to encouraging greater corporate responsibility reporting may be a response to its stakeholders' interests and concerns in relation to its ethical practices.

Greater transparency and public reporting is important in delivering better ethics in practice, particularly if we accept that more symptomatic indicator-reporting leads to a greater focus on these performance areas.

There is acknowledgement within the reviewed firms that there may be an opportunity to be recognised as "the ethical firm" and in so doing moving ethics in practice from risk management to a market differentiator. Nevertheless we were unable to identify an Australian firm that has publicly and explicitly sought to differentiate itself from its peers in regard to its ethical practices *per se* and reporting thereof.

#### **4.3.1. Transparency recommendation**

Potential clients of the firms should consider requesting lead and symptomatic indicators results from those that they are considering appointing.

Beyond users of the firms' services, other stakeholders of the profession could also begin to request this additional information relating to ethical performance and ask specifically that it be put in the public domain so that those stakeholders can come to their own conclusions in relation to ethical performance.

Company directors, when considering audit reports, could request of the auditor an explanation of how ethical practice has been assured in the conduct of the assignment.

#### **4.4. *The FRC going beyond independence?***

Post-Enron and HIH, the accountancy profession's stakeholders and the profession itself have focused on improving performance in terms of independence and quality. This response has been largely driven through regulatory developments resulting in significant investments at the firm level in systems and processes.

The wider scope of this consultancy, with its broader business ethics considerations, has created considerable questioning from those who participated. They have seen the FRC's only role as supervising the profession in terms of its approach to independence.

This initial response was notable in the context of the firms already going well beyond compliance, to encourage ethical practices across their organisations. All the firms explicitly recognised the role that a values-based approach to building culture plays in delivering preferred behaviours, including ethical behaviour, from employees.

The supervision of ethics in practice within the accounting profession could go beyond independence, but to do so the FRC needs to overcome the current equating by the firms of a "supervisory role" with compliance.

##### **4.4.1. *Beyond independence recommendation***

In considering what role the FRC has in the business ethics space beyond independence compliance, it should also consider the commonly stated "review and assessment fatigue" amongst firms. Whatever role the FRC seeks to play, it should ensure that the role assumed does not become a barrier to more firms choosing to go beyond compliance and aiming for leading ethical practices.

#### **4.5. *Can the FRC show greater leadership?***

In the light of recent community debate, for example the release of the Second Edition of the ASX Corporate Governance Principles and Recommendations, Banarra believes it is timely for the FRC and other stakeholders of the accountancy profession to reconsider the balance

between principles- and rules-based approaches to ensuring ethical practice.

Our research identified that the accountancy profession in the US is subjected to a primarily rules-based approach to ethics, while the UK is more principles-based. A general view was expressed within the firms we interviewed that the Australian approach is becoming increasingly rules-based. This development would appear to be out of step with the corporate governance sector, if this assertion from the ASX Corporate Governance Council is accepted:

*This document marks the first revision of the Council's corporate governance Principles and Recommendations since they were issued in March 2003. This is testimony to the durability of Australia's flexible, principles-based approach to corporate governance. While some other major jurisdictions are unwinding their governance frameworks because of unworkability, Australia has been able to refresh its approach rather than undertake a rewrite. (pg 2, Second Edition of the ASX Corporate Governance Principles and Recommendations: 2007)*

A 2003 study conducted by the U.S. Securities and Exchange Commission *Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System*, concluded:

*As a result of our study, the staff recommends that those involved in the standard-setting process more consistently develop standards on a principles-based or objectives-oriented basis.*

#### **4.5.1. FRC leadership recommendation**

FRC could show leadership by both facilitating and participating in the debate on the dynamic and evolving tensions between a principles-based and rules-based approach to encouraging ethical behaviour within the profession.

## 5. Areas for future investigation

The review identified a number of issues relating to ethical performance which may impact firms, but were considered to be outside of review scope. These include:

- Ethics in practice for others involved in the financial reporting “chain” such as company directors, professional accountants within business and government, financiers, lawyers and journalists;
- The role and practice of company audit committees in ensuring ethics in practice both within the audit service provider and the auditee company;
- The extent to which stress (e.g. individual stress/depression, company financial health or national economic situation) within an organisation increases the risk of unethical behaviour;
- The challenge to firms in losing staff because of the restrictions placed on those staff and their spouses by auditor independence compliance requirements;
- The challenge to firms from the merging of cultures, post-acquisition. Will the profession see ethical due diligence?
- What is the extent of awareness of what is ethical behaviour in non-audit functions and is it as high as that within the audit and assurance service line?
- The tensions and potential gaps arising from co-regulation of ethics in practice between professional bodies and government entities; and
- The desire of firms to get more feedback on FRC’s work (e.g. the findings of the Teaching of Ethics consultancy work).

We suggest that FRC gives consideration in its future work program as to the relative merits and priorities in addressing some or all of these areas.

## 6. Appendices

### 6.1. **Appendix A – Methodology**

Banarra has conducted the review using a modified Banarra Assurance Methodology (BAM). BAM meets the requirements of the AA1000 Assurance Standard for sustainability assurance and we have used it to deliver both Stage 1 and 2 of the review.

In Stage 1, Banarra used four parts of the five-part materiality test as described by AccountAbility in their July 2003 publication *Redefining Materiality, Practice and Public Policy for Effective Corporate Reporting*. The tests guided the nature of our Stage 1 research as detailed below.

#### 6.1.1. **Stage 1 - Research & Materiality Register**

The five-part materiality test covers five lines of enquiry:

1. Stakeholder behaviour and concerns (what do employees, clients and other stakeholders expect?). Research inputs included:
  - Media search (relevant articles from publications such as Accountancy Age, CFO Magazine, Forbes Magazine, Australian Financial Review and The Age);
  - Literature search (relevant papers from academics such as Prem Sikka – University of Essex, Ken McPhail – University of Glasgow, Tom Campbell – Australian National University and Jack Flanagan – University of Notre Dame Australia);
  - Blog search (relevant blogs from online commentators including accounting students and Big Four Alumni);
  - Review of the findings of the report to the FRC on the teaching of ethics (Jane Walton); and
  - Interviews with 15 key informants (see Appendix C below for details).
2. Policy-based performance (what standards have firms set for themselves?). Research inputs included:
  - Review of the publicly-available policies, reports, speeches and other commitments made in relation to ethics by the seven review firms (Deloitte, Ernst & Young, Grant Thornton, KPMG, PKF, PwC, and WHK Howarth).
3. Peer-based norms (what are the firms with leading ethical performance doing?). Research inputs included:

- Review of the publicly-available ethical policies and performance from four overseas firms identified as demonstrating leadership in this area (Plante Moran, Moss Adams, BKD and BDO Stoy Hayward in the US)
4. Societal norms (what regulatory and non-regulatory standards exist?). Research inputs included:
- Review of ethical codes and other guidance from international accounting bodies (International Federation of Accountants and Association of Chartered Certified Accountants);
  - Review of ethical codes and other guidance from national accounting bodies (Certified Practising Accountants Australia, National Institute of Accountants and Institute of Chartered Accountants in Australia); and
  - Review of the publicly available reports from ASIC inspection programs and AQRB questionnaires.
5. Direct, short-term financial impacts (what are the types of ethical issues with the greatest financial impacts?)
- Banarra usually relies on reviewing sources such as Board papers in this line of research, however we believed we had not established a level of trust that would have allowed for this level disclosure. With four other lines of research informing the identification of issues we do not believe the materiality test process should be qualified.

The information collected in Stage 1 was entered into NVivo, qualitative research software. We coded all the material and this resulted in 139 issues identified in our Materiality Register (see Appendix D for summary register) and from this universe our materiality criteria identified 40 top material issues. This set of issues was then overlaid with the Statement of Work objectives to arrive at the six testing subject matter issues:

- Tone at the top and tone throughout
- Managing tensions between different interests
- Encouragement and protection of whistleblowers
- Investigation, discipline and reward
- Effectiveness of ethical training
- Declining work on ethical grounds

These testing subject matter areas were the basis for the Stage 2 engagements.

### **6.1.2. Stage 2 – Data gathered from the firms**

An initial opening meeting was held with all seven firms, with those referred to Banarra as each firm's contact person. These contact people were identified by each firm's Managing Partner after an introductory letter from the FRC Chairman, Charles Macek.

Before each meeting, we provided a high level questionnaire covering the six testing subject matter areas. This then provided the agenda for discussion at the opening meetings that were conducted both face to face and via the telephone. The collective results from these opening meetings were used to prepare a detailed questionnaire.

Once six of the seven opening meetings were completed a detailed questionnaire was provided (see Appendix E). This was used to prepare for both detailed document provision and for additional interviews. As a result, we reviewed a significant amount of documentation and interviewed over 25 firm representatives (listed in Appendix G). We also visited all seven firms in person during this stage.

We acknowledge that our findings are indicative of the ethical practice areas and processes described in this report. In our data collection in Stage 2 we may not have fully identified all of the relevant practices that we have described within this report. We do believe, however, that our findings are based upon the evidence provided by the firms and, if there are discrepancies, then these are only minor in nature.

In Stage 2, Richard Boele presented the initial Stage 1 results to the full FRC.

### **6.1.3. Stage 3 – Analysed data from the firms**

All of the data gathered in Stage 2 was entered into NVivo to assist with analysis. The results of this analysis are presented as findings in this report. The report was drafted by Richard Boele and reviewed by Katharine Walters and Julian Crawford.

In Stage 3, there was one presentation of the findings to the Auditor Independence Committee and one presentation of the draft report.

### **6.1.4. Methodological issues and limitations**

When Banarra originally proposed using a modified version of BAM to undertake this review, we had not appreciated that we would be so clearly viewed by the subject firms as acting on behalf of FRC as a regulator.

Accordingly, establishing the levels of trust and access that we receive with our usual assurance clients was not possible with all firms. This necessarily reduced the extent of our findings and the value we that

we would normally deliver within a regular assurance assignment. That said, the findings we have made are based upon the evidence we collected and our analysis of that evidence providing us full confidence of the findings presented in this report.

The actual resources available to this project in examining each firm were limited relative to the resources that an ASIC review deploys. As our methodology differs in emphasis, the findings are relative.

Users of this report should note that only ASIC's publicly available findings informed our work. When evaluating the firms, we specifically sought to avoid areas that had already been reviewed by ASIC or where we understood (from the firms?) that ASIC was intending to review. The approach of each firm to independence was an area on which we spent little time having understood that this was covered by a number of other review processes such as ASIC, and for the Big 4, AQRB, along with the profession's representative bodies.

From the firms' responses, it appeared to us that our testing subject matter and approach were different to those of ASIC. We believe this demonstrated that we were covering, to some extent, new ground on behalf of the FRC.

All the firms were surprised that the FRC had commissioned a consultancy that considers the broader area of business ethics in practice. This was seen as a significant departure from the FRC's legislated responsibilities. While statements were made to Banarra that the FRC had no legal authority for conducting a review with the scope that we were proposing, there was significant cooperation from all seven of the firms. Indeed, some firms are to be commended for their transparency and frankness with Banarra

We refer all users of our work to qualitative social research theory to understand both the strengths and limitations of approaching the delivery of this review using qualitative social research.

**6.2. Appendix B - Introduction Letter & Statement of Work**

18 May 2007

SYDNEY NSW 2000

*[by fax to]*

Dear

I am writing to advise you that the FRC recently agreed to the engagement of The Banarra Trust (Banarra) to provide consultancy services to the FRC.

The consultancy, which requires Banarra to evaluate how professional and business ethics are applied in practice by accounting firms (an extract from the statement of work for the consultancy appears below), is essentially a follow-up to work undertaken in 2006 on the teaching of professional and business ethics by, or on behalf of, the professional accounting bodies.

Richard Boele of Banarra has primary responsibility for the project and is being assisted by Katherine Walters and Julian Crawford.

Mr Boele and the members of his team will be contacting your firm in the course of their work and I would appreciate it if you could provide them with any assistance you can so that they can fulfil their duties.

Thank you for your assistance in this matter.

Yours sincerely

Charles Macek  
FRC Chairman

### **Statement of Work**

1. The purpose of the consultancy is to evaluate how professional and business ethics are applied in practice by accounting firms. It is envisaged that the consultancy will consider the Big 4 accounting firms and three firms agreed by the Consultant and the Audit Independence Committee of the Financial Reporting Council (FRC) in the group immediately below the Big Four firms.
2. Without limiting the scope of the work to be done, it is expected that the Consultant will consider:
  - (a) the extent to which the accounting firms ensure their partners and staff are aware of, and comply with, the ethical requirements of the professional accounting bodies;
  - (b) whether the accounting firms have their own ethical requirements which supplement those of the professional bodies and, where they do, the extent to which partners and staff comply with them;
  - (c) whether accounting firms take disciplinary or other action against partners or staff who fail to comply with the ethical requirements of either their professional body or the firm;
  - (d) whether firms reward partners and staff for maintaining high ethical standards, even in circumstances where there is a resultant financial loss to the firm; and
  - (e) any observations, findings or recommendations made by the consultant who reviewed the teaching of professional and business ethics by, or on behalf of, the professional accounting bodies about the manner in which professional and business ethics are applied in practice by accounting firms.
3. The Consultant will prepare a report for the FRC detailing their findings and including recommendations for further actions that could be considered by the FRC.
4. The performance of the work specified in paragraphs 2 and 3 will be undertaken in three stages:
  - (a) research concerning the environment, processes and procedures impacting on ethical performance in accounting firms;
  - (b) testing the extent to which the accounting firms being considered can identify, understand and respond to the issues associated with their ethical performance; and
  - (c) preparation of a report by the Consultant on their findings and recommendations.

5. A work plan describing the work to be performed under each of the stages listed in paragraph 4 is to be submitted to the Treasury, at the address specified in clause 26.1.2 of the Contract, no later than five (5) Business Days after the execution of the Contract.
6. In undertaking this consultancy, the Consultant will be required to:
  - (a) work with:
    - (i) the Audit Independence Committee established by the FRC to assist the FRC in the performance of the auditor independence functions;
    - (ii) the principal consultant appointed to provide guidance and advice to the FRC in the performance of the auditor independence functions; and
    - (iii) the FRC Secretariat; and
  - (b) attend, at the request of the Chairman of the Audit Independence Committee, meetings of the Committee and the full FRC for the purpose of reporting to, or consulting with, members of those bodies on the work being performed under the consultancy.
7. The Consultant will deliver a draft of the report referred to in subparagraph 4(c) by no later than 5 June 2007 and the final report by no later than 19 June 2007.

### **6.3. Appendix C - Stage 1 Key Informants**

1. Accounting Professional & Ethical Standards Board, Channa Wijesinghe, Senior Project Manager.
2. American Institute of Certified Public Accountants, Barry Melancon, CEO.
3. Australian Institute of Company Directors, Antony Robb.
4. Australian Institute of Company Directors, Mark Blair, Senior Policy Advisor.
5. Australian National University, Kerry Jacobs, Professor.
6. Australian Securities & Investments Commission, Juliet Low, Manager Audit Regulation Team.
7. Australian Securities & Investments Commission, Lee White, Chief Accountant.
8. CPA Australia, Dennis Pratt, General Manager of Standards and Public Affairs.
9. Financial Reporting Council, Auditor Independence Committee, Elizabeth Alexander, Chair.
10. Financial Reporting Council, Charles Macek, Chair.
11. Institute of Chartered Accountants in Australia, Bill Palmer, General Manager, Standards & Public Affairs.
12. Institute of Chartered Accountants in England and Wales, Tony Bromell, Head of Accountancy Markets and Ethics.
13. International Ethics Standards Board for Accountants, Richard George, Chairman.
14. Investment and Financial Services Association, Martina Coda, Senior Policy Manager.
15. St James Ethics Centre, Simon Longstaff, Executive Director.

## 6.4. **Appendix D - Materiality Register**

### **Top Material Issues (Ranked by Importance)**

Banarra's research identified the following 15 top material performance areas and issues.

Table key: T1 = Test 1: Stakeholder concerns (e.g. key informant interviews, media)

T2 = Test 2: Policies & commitments (e.g. target firm codes of conduct, public speeches)

T3 = Test 3: Peer reporting (e.g. BDO, BKD, Moss Adams, Plante Moran)

T4 = Test 4: National and International norms (e.g. IFAC, CPAA, ICAA, NIA)

	T1 Stakeholders	T2 Policies	T3 Peers	T4 Norms	No. of tests	No. of refs
1. Firm ethical culture\Tone at the top, leadership example setting	11	11	4	11	4	37
2. Firm ethics responses\Internal and external complaints system\Whistleblowers, protection and encouragement for	16	12	5	2	4	35
3. Firm ethics responses\Current ethics training and effectiveness	10	6	1	6	4	23
4. Professional competence and due care\Diligently and in accordance with standards, acting\Rules and principles, balance between	10	3	0	9	3	22
5. Professional behaviour\Responsibility to act in public interest\Letter and spirit of law, balance between	10	4	1	6	4	21
6. Professional behaviour\Action that discredits profession, avoidance of\Public interest or ethics and financial gain, conflict between	11	2	3	2	4	18
7. Objectivity\Conflict of interest\Identification of potential conflicts of interest, process for	11	4	1	2	4	18
8. Firm ethical culture\Transparency and accountability, degree of	9	6	1	2	4	18
9. Objectivity\Independence from client\Advisory and audit services, issues with providing	9	2	0	6	3	17
10. Firm ethical culture\Tone at the top, communication and integration of	5	4	4	3	4	16
11. Professional competence and due care\Diligently and in accordance with standards, acting\Execute quality work carefully, thoroughly and timely	8	2	3	3	4	16
12. Professional competence and due care\Professional knowledge and skill\Continuing professional development, maintenance of	2	7	4	2	4	15
13. Firm ethical culture\Equity of opportunity and gender diversity	3	7	5	0	3	15
14. Objectivity\Independence from client	8	2	0	5	3	15
15. Objectivity\Conflict of interest\Self-interest and personal or family member interests\Financial interest in client company	9	1	0	3	3	13

**6.5. Appendix E - Detailed Questionnaire**

**FRC Ethics in Practice Firm Questionnaire**

The following questions are designed to help both you and Banarra determine what documents are required and what interviews and other evidence collection activities it would be desirable for Banarra to undertake while visiting your firm.

Banarra is not expecting that there is a response to every one of the following questions. We are also open to the firm providing an alternative response or approach to the question from that one that may be implied.

<b>Material Issues</b>	<b>Notes</b>
<b>Tone at the Top &amp; Tone Throughout</b>	
What are the processes your firm has that provide monitoring of tone at the top and tone throughout?  Where are the results reported?	
What are the most senior decision-making groups and individuals that have responsibility for ethics with the firm? Is there any formal independent oversight?	
How does the firm's leadership ensure it 'walks the talk' in terms of ethical conduct? Have there been any examples of partners being called to account by other partners in this regard?	
What specific initiatives been undertaken to respond to the opportunities in terms of ethical performance identified?	
Can we see the trended full results from the last three employee surveys?  We will focus on the questions that reflect either directly or indirectly the health of the ethical culture.  Are the firm's values measured in the staff survey?	

What ethical issues have been identified in the past three cycles from analysis of the qualitative (open) question results in your employee surveys? Can we see the results of analysis and hierarchy of issues identified?	
Does your firm internally report to management on ethical culture using indicators from the employee survey? If so we would like to see evidence.	
Does your firm conduct a specific stand alone ethics or cultural survey?	
How is the firm monitoring and measuring the extent to which employees are aware of the ethical requirements of the accounting bodies?	
How is the firm monitoring and measuring the extent to which employees are aware of the firm's own ethical requirements (national and international where applicable)?	
In client surveying; are there questions specifically relating to testing their perception of how ethical the firm and its representatives are?	
Is there surveying of recent recruits on their actual experience of the firm's ethical culture versus their expectations?	
Is exit interviewing specifically exploring ethical issues? If so what does the aggregated trend analysis say? If not, are the issues results in voluntary separation being trended?	
How does the firm manage the induction of ethical culture to employees transferred from other countries, lateral hires and following mergers and acquisitions?	
Are ethics incorporated into the screening process for new hires?	
<b>Balance between Client and Public Interest</b>	
There are related aspects to this issue such as; resolving tensions between the letter and spirit of the law; between firm financial gain and public interest; and between client and public interests.  What fora and mechanisms are there for supporting those within the firm who need to identify and resolve conflicts in this area?	
Please identify two cases that illustrate how the firm is resolving these tensions. We will then	

understand these and select two/three key decision makers and interview them in relation to these cases to gain an understanding of the process.	
Do firm post-engagement reviews incorporate discussion of client ethical performance and integrity?	
<b>Encouragement and Protection of Whistleblowers</b>	
How is your firm responding to the challenge of encouraging whistleblowing in practice?	
Is there monitoring of the level of employee (and other users such as clients') awareness of and trust in the whistleblowing mechanisms and procedures?	
Is there monitoring on satisfaction with these mechanisms by those who use them?	
Is the effectiveness of response to issues raised monitored? (qualitative and quantitative)	
How many cases have been raised through the mechanisms? Total employee population that may be using the mechanism.	
How many complaints of retribution in the past two years have been recorded?	
What other mechanisms are available for employees wishing to raise concerns? Do the relevant staff (e.g. general helpdesk staff) undergo training in how to deal with ethical queries?	
<b>Investigation, Discipline, and Reward</b>	
Do firm, partner and/or employee objectives, targets and performance measurement explicitly address ethics?	
Is there a direct link between measurement of ethics practice and remuneration?	
Is there measurement of the ethics performance dimensions and if so is this aggregated?	
Reward process – how is ethical performance recognised, rewarded and communicated?	
Reward process – is ethical decision making rewarded to the point that there may be financial loss to the firm?	
To what extent does performance appraisal	

ensure compliance with the ethical requirements of the accounting bodies?	
To what extent does performance appraisal ensure compliance with the firm's own ethical requirements?	
What is the process and escalation path for investigating ethical conduct?	
Is the effectiveness of investigations measured?	
Is there evidence of root causes being identified and appropriate responses being implemented?	
How does the firm ensure that discipline relating to ethical conduct is consistently applied and the when it is that it is communicated throughout the firm?	
What are the penalties for breaches of ethical conduct?	
<b>Effectiveness of Ethical Training</b>	
What types of ethical training does your firm provide? What is the coverage of this training?	
What is your firm's approach to monitoring and reporting the effectiveness of ethical training? Are there training evaluations that specifically measure effectiveness of the ethics dimensions?	
How does the firm ensure employees are able to put theory into practice?	
How does ethical training address the 'grey areas'?	
How does the firm identify emerging ethical issues and incorporate them into training?	
<b>Declining Work on Ethical Grounds</b>	
What are the criteria and what support is given to those considering declining a client in terms of the ethics and integrity of the potential client? How does the firm know these criteria are consistently applied?	
Does the firm track work declined on ethical grounds?	
Please provide two cases of where ethical based decision making has resulted in a financial loss to the firm.	
One case where ethical issues were significant but the client was accepted after consideration.	

Two cases of post acceptance or continuation where a client has been let go because of a subsequent ethical call. And the ongoing processes that allow these cases to be identified.	
What are the mechanisms to facilitate collegial decision making in this area?	
<b>'Symptomatic' indicators</b>	
Is diversity in terms of gender of the firm's workforce monitored? What are the trends?	
Is diversity in terms of ethnic background of the firm's workforce monitored? What are the trends?	
Is perception of work/life balance monitored? What are the trends?	
What is the incident rate of depression, or those seeking support for depression within the firm?	
How transparent and accountable is the firm internally and externally regarding its financial and non-financial commitments and performance? How does the firm identify and engage with its stakeholders?	
What public promotional or research work has the firm done in terms of ethics in the business community?	
<b>General</b>	
What internal and external ethical assurance reports are there that report on the firm's ethical performance?	
What ethical issues are identified in your risk register(s) & strategic planning?	
Is there a table that translates the firm's ethics code's commitments into metrics?	
Are there the reports from internal (either national or global) assurance conducted in terms of the firm's ethical performance?	

**6.6. Appendix F – Second Letter from FRC clarifying scope and purpose of review**

6 June 2007

SYDNEY NSW 2000

Dear

Further to my letter of 16 April 2007, I am writing to thank you for the assistance you have been giving to Richard Boele and his team at Banarra on their undertaking of consultancy services for the FRC.

I would like to take this opportunity to provide you with further background on this consultancy, in particular its relation with FRC's core functions and the nature of its expected output.

The FRC is charged with monitoring the effectiveness of auditor independence requirements in Australia. Its specific auditor independence functions include monitoring and assessing the systems and processes used by Australian auditors to ensure compliance with auditor independence requirements and also promoting and monitoring the adequacy of the teaching of professional and business ethics as related to auditor independence.

As indicated in my letter of 16 April, the consultancy with Banarra is a follow up to work undertaken in 2006 on the teaching of professional and business ethics by, or on behalf of, the professional accounting bodies. The consultancy with Banarra is aimed at assessing how professional and business ethics are applied in practice by accounting firms. The FRC is of the view that a proper assessment of the adequacy of the teaching of professional and business ethics requires some research on how this teaching translates into actual ethical behaviour at the firms.

I would also like to assure you that the report that Banarra will produce for the FRC will be focused on general observations that result from its research into the practices of the accounting firms and will not include references to detailed observations on any particular firm. Banarra has noted that the methodology they are using is common to their assessments of ethical practices across sectors. I would also like to note that Banarra is bound by a confidentiality agreement included in its contract to provide consultancy services to the FRC.

I understand that Mr Boele and the members of his team have already contacted your firm and the initial responses have been very positive.

Please do not hesitate to contact me if I can be of any further assistance.

Thank you once again for your assistance in this matter.

Yours sincerely

Charles Macek

FRC Chairman

## 6.7. **Appendix G – Stage 2 Firm Interviewees**

### **Deloitte**

1. Caithlin McCabe, National Audit Services Leader and Regulatory Readiness Partner
2. Marisa Orbea, Independence and Conflicts Partner
3. David Lombe, Partner & Ethics Officer
4. Margaret Dreyer, Partner, People Partner, Assurance and Advisory & Inspiring Women Leader

### **Ernst and Young**

5. David Balcombe, Partner, National Director of Independence & Policy
6. Graham Ezzy, Head of Audit
7. Ian Miller, Head of Quality & Risk Management
8. Jacqueline Maroney, Principal
9. Amy Canny, Senior Compliance Officer

### **Grant Thornton (Sydney)**

10. Keith Reilly, National Head of Professional Standards
11. Andrew Archer, Partner
12. Margaret Fisher, National Director HR
13. Andrew Rigele, Partner Quality Control & Risk Management

### **KPMG**

14. Stephen Hawke, Partner, Ethics and Independence
15. Joel Lucas Senior Manager, Risk Management
16. Jeffrey Pearse, Executive Director - Human Resources
17. JoAnne Stephenson, National Partner in Charge - Risk Advisory Services
18. Peter Nash, National Managing Partner - People, Performance & Culture

### **PKF (Melbourne)**

19. Michael Phillips, Partner Melbourne
20. Tim Draffen, HR Manager

**PwC**

21. Bill Edge, OneFirm Risk & Quality Lead Partner
22. Graham Porter, Director, OneFirm Risk & Quality
23. Leigh Minehan, Deputy CEO
24. Valerie Clifford, OneFirm Risk & Quality

**WHK Howarth (Sydney)**

25. Ray Osborne, Principal WHK Horwath (Corporate Advisory)
26. Bruce Hatchman, was CEO now Principal, Acquisitions, WHK Horwath
27. Merylyn Speiser, General Manager – HR, WHK Horwath
28. Mark Geldens, Principal (Wealth Management)
29. David Sinclair, Principal (Audit and Assurance)