



Title	Good faith reporting by trainee auditors
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Introduction

As incidents of whistleblowing continue, the topic is likely to remain a permanent feature on corporate and political agendas for the foreseeable future. It is a phenomenon Ireland has come to love, despise and practice habitually. Over the last decade political, religious, social and commercial institutions have felt the full effect of revelations of corruption, tax evasion, fraud and management negligence exposed by whistleblowers. Companies are putting in place mechanisms to encourage staff to bring concerns to the attention of senior management. The term “good faith reporting” is being adopted to reduce the negative connotations associated with the term “whistleblowing”.

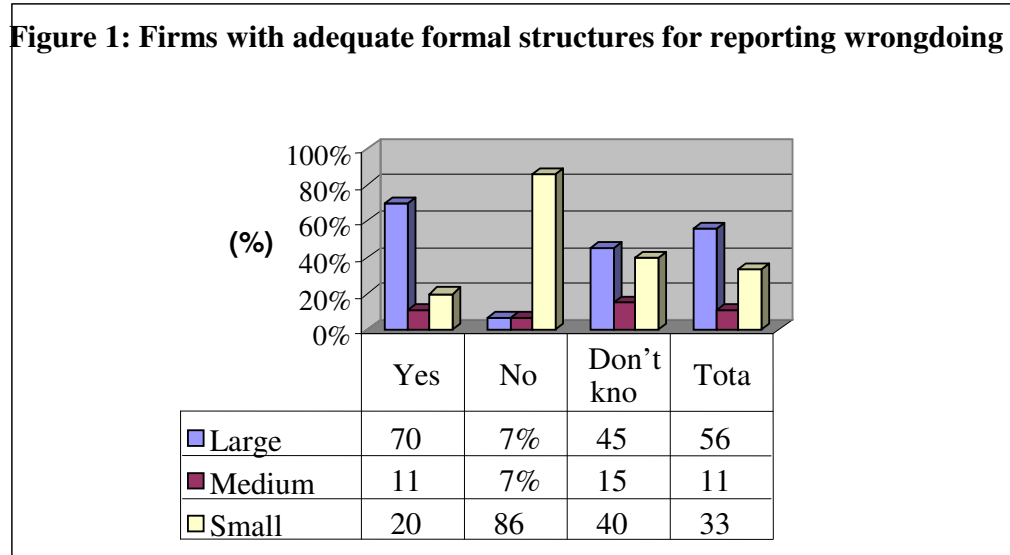
The topic has taken on particular significance for the auditing and accountancy profession in the wake of corporate scandals such as Enron, WorldCom, Parmalat, Elan and so on. Such scandals have rocked the very foundations of the profession and have raised questions concerning the ability or willingness of auditors to report corporate malfeasance. Auditors are placed in a unique position by virtue of the access they enjoy to clients’ records, accounts and boards of directors. This access is symbolic of the close relationship that may exist between a company and its auditor. Such relationships are fraught with potential ethical dilemmas, as accountants are subject to a variety of conflicting pressures from their employer, their profession and their clients.

This article investigates some of the factors that influence the trainee auditors in deciding to raise concerns. A survey of 240 final year students of the Institute of Chartered Accountants in Ireland was undertaken in June 2004. The following is a summary of the principal findings of this research.

Internal Reporting Environment in Accountancy Firms

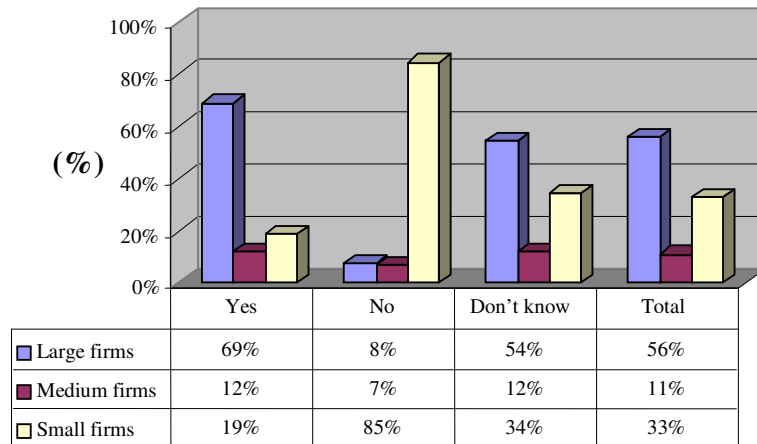
The internal reporting environment in accountancy firms has a significant influence on the decision by audit trainees to raise concerns about observed or suspected wrongdoing. For the most part, accountancy firms have a formal management hierarchy, or as one respondent referred to it “*a hierarchy of authority*”. This hierarchy acts as a chain of command within which issues can be reported to a more senior level within firms. Respondents were asked whether their firm had adequate formal structures for reporting instances of suspected or actual wrongdoing. The responses are presented below and have been categorised according to firm size (a large firm is one with greater than 500 staff, a medium firm has between 100 and 500 staff, while a small firm has less than 100 staff).

The findings reported in Figure 1 clearly show that trainee auditors in small firms do not believe that their firm has in place adequate structures for reporting instances of actual or suspected wrongdoing.



From our research it is clear that the internal reporting environment in accountancy firms is significantly affected by size. For audit firms with a whistleblowing policy, Figure 2 once again shows that the larger firms are significantly more likely to have a formal policy in place. We found the majority of respondents working for large firms stated that their firm had adequate formal structures in place and that their firm had a whistleblowing policy. This cannot be said of the small firms. However, regardless of firm size, a significant proportion of respondents did not know whether their firm had adequate formal structures in place nor could they say whether or not their firm had a whistleblowing policy. Only 52% of respondents stated that their firm has a whistleblowing policy, while 35% of respondents did not know whether such a policy existed. This finding would suggest that firms could do more to communicate such policies to their staff.

Figure 2: Categorical analysis of firms that have a whistleblowing policy



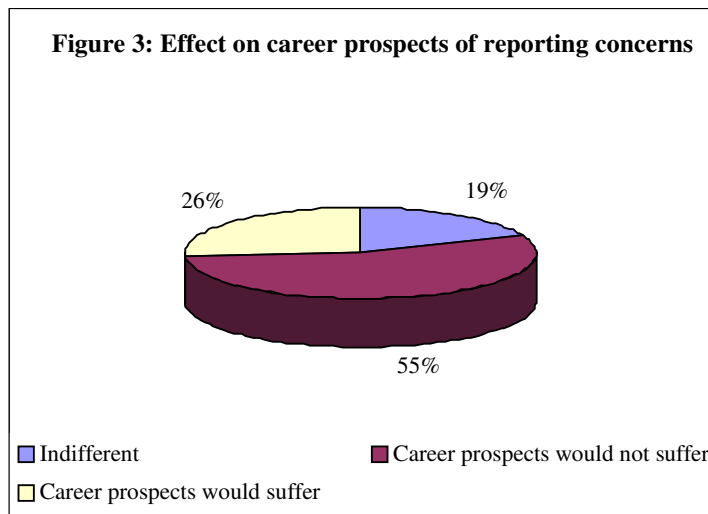
Confidence in Internal Reporting Structures

We measured the level of confidence among trainee auditors in the internal reporting structures by reference to how respondents felt their career prospects might be affected by reporting a matter of concern internally. Respondents were asked to state, on a five point Likert scale, whether or not they agreed with the following statement; *“If I reported a matter of concern internally within my firm using formal reporting structures, my career prospects would not suffer.”*

As can be seen from Figure 3, the majority (55%) of respondents felt that their career prospects would not suffer were they to report a matter of concern internally within their firm.

Two factors were found to significantly influence the level of confidence among trainee auditors in the internal reporting structures within their firm. Firstly, where formal structures are present in the firm, trainee auditors have greater confidence that their career would not suffer by reporting concerns internally. Secondly, where trainee auditors had received training in their statutory duties to whistleblow, they expressed greater confidence in the internal reporting structures.

Figure 3: Effect on career prospects of reporting concerns

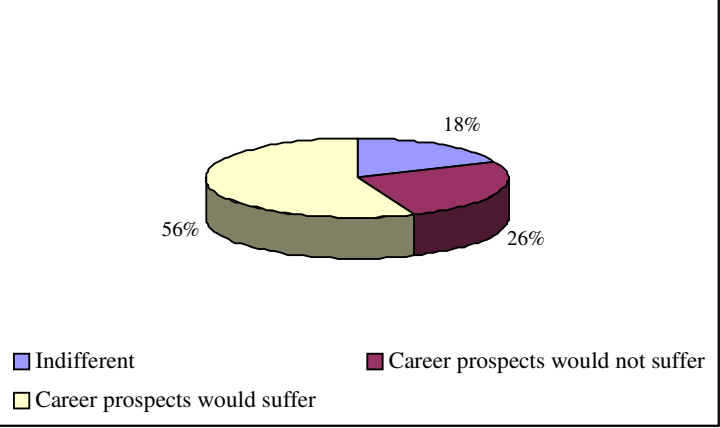


Confidence in External Reporting Structures

The effect on career prospects of reporting concerns externally was then investigated. Respondents were asked to state their level of agreement with the following statement; *If I were forced to report a matter of concern to an external authority my career prospects would not suffer*. In contrast to reporting a matter internally, as shown in Figure 4, the majority (56%) of respondents felt that by reporting a matter externally their career prospects would suffer. This compares with a corresponding figure for reporting internally of only 26%. This finding indicates significantly different views on reporting matters externally versus internally.

However, views differed depending on level of seniority. A significant proportion of audit seniors indicated they did not believe their career would suffer by reporting externally, suggesting that the longer the trainee auditor works for the firm the greater confidence they have that reporting externally would not adversely affect their career. Once again we found that respondents who had received training in their statutory duties to whistleblow displayed greater confidence that their career would not be adversely affected by reporting externally.

Figure 4: Effect on career prospects of reporting concerns externally



Willingness of Trainee Auditors to Challenge Audit Partners

The willingness of trainee auditors to challenge an unsatisfactory response from the Audit partner was measured by use of scenarios. Four scenarios were used, three dealing with financial/accounting issues and a fourth dealing with a non-financial situation. Each scenario presented a different ethical dilemma for the respondents. Importantly, in order to test the willingness of trainee auditors to accept an unsatisfactory response by the audit partner, the scenarios indicated that the audit partner was aware of the unethical practice and of concerns raised by the audit senior but was unwilling to take corrective action.

Respondents were asked three questions in each scenario: Firstly to rate the seriousness of the situation presented; Secondly, to rate their satisfaction with the audit partner’s response to the concerns raised by the trainee auditor, and finally to select a further course of action. We found that in each scenario the majority of respondents indicated that they would take further action to report the matter, be it internally or externally. However, we found that across each of the scenarios no more than 64% of respondents were willing to report the issue internally. This finding suggests that accountancy firms must do more to encourage trainee auditors to report matters of concern internally.

Furthermore, we found in the case of the non-financial scenario (dealing with unsafe disposal of medical waste) a significant difference among respondents. This scenario was perceived by respondents to be the least serious of the four with only 63% of respondents indicating that the issue was serious. What is interesting in this instance is that the sample was almost equally divided between the three broad courses of action, namely to report the matter internally (33%), report the matter externally (32%) that is, to the authorities or the media, and to do nothing (30%).

These findings indicate a hesitation on the part of trainee auditors to report matters of concern internally, particularly matters regarding non-financial wrongdoing. Our research highlights two important issues: Firstly, wrongdoing of a non-financial nature is not deemed by trainee auditors to be as serious as wrongdoing of a financial nature; and Secondly, where wrongdoing of a non-financial nature is observed, trainee auditors are

more reluctant to report the matter internally, choosing instead to take no action or report the matter externally. These findings have important implications for accountancy firms.

Implications for Accountancy Firms

Our research has three important implications for accountancy firms. Firstly, we found that a substantial number of trainee auditors are prepared to report a matter of concern externally where they believe the matter to be serious enough. In the current environment, with ever-greater regulatory supervision, it is preferable that concerns be raised internally. This implies that accountancy firms must do more to encourage trainee auditors to report concerns internally.

Secondly, where formal reporting structures are present in the firm, trainee auditors exhibit greater confidence that reporting a matter of concern internally will not affect their career. Given that in each scenario the majority of respondents indicated that the issue was serious and furthermore that they were dissatisfied with the Audit Partner's response, it is surprising that more did not choose to report the matter internally. This suggests that accountancy firms need to examine their internal reporting structures. In particular, emphasis should be placed on encouraging trainee auditors to voice their concerns internally, thereby allowing a more effective organisational response.

Finally, where training is provided to trainee auditors they display greater confidence in reporting internally. Given this finding, firms should look at their training programmes and place greater emphasis on informal mechanisms such as peer discussion in order to create a culture where concerns can be raised and openly discussed. As Thorne and Hartwick¹ state "*Professional judgement...can be seen as a combination of being "correct" (technical judgement) and being "good" or "right" (moral judgement)*". It is therefore important that training programmes in accountancy firms emphasise not only the technical side of professional judgement but also the moral side.

Summary and Conclusion

To conclude, "*All organisations face the risk that certain employees may engage in conduct that violates the law, regulations or the policies of the organisation itself*". This is the opening line from the Bank of Ireland's "*Good Faith Reporting Policy*", issued in July 2004. This statement describes the problem facing organisations the world over, including accountancy firms. While this is not a new problem, what is new is that organisations such as Bank of Ireland accept that they can no longer ignore the possibility that some employees within their ranks may be engaged in illegal, immoral or illegitimate practices.

With regard to accountancy firms our results indicate that small firms do not have adequate policies or structures in place to deal with the reporting of wrongdoing. Accountancy firms must do more to encourage the reporting of concerns internally, especially where concerns relate to issues of a non-financial matter. We found that firms can encourage

reporting concerns internally by adopting formal reporting structures and training their staff to use such structures.

The positive terminology used by the Bank of Ireland is also significant, suggesting that those who raise concerns internally will be rewarded by the company rather than suffer retaliation. Such positive interpretation of the actions of whistleblowers is welcome and should be embraced by all Irish organisations.

Furthermore, given that obligations upon auditors to report matters to external authorities are expanding, it is important that accountancy firms develop policies to support their employees similar to the Bank of Ireland's good faith reporting policy.

John Kelly is a trainee auditor with PricewaterhouseCoopers. This article is based on his Master of Accounting dissertation completed at University College Dublin. Niamh Brennan is Michael MacCormac Professor of Management at UCD.

¹ Thorne L. and J. Hartwick: 2001, 'The Directional Effects of Discussion on Auditors Moral Reasoning', *Contemporary Accounting Research* 18 (2), 337-361.