



Ethical Risk Assessment and Auditing:
what is it and how to go about it?

Track F



***Ethical Risk Assessment and
Auditing:
what is it and how to go about it?***

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AGENDA

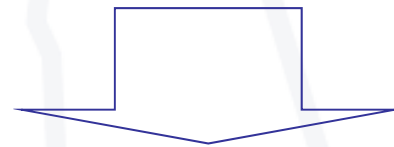
- ✓ *Framing the issue*
- ✓ *Ethical Risk Assessment*
- ✓ *Corporate Social Responsibility*
- ✓ *CSR and Financial Performance*
- ✓ *CSR and Business Ethics*
- ✓ *Ethical Risk and Value of the firm*
- ✓ *Ethical Risk and Auditing*





FRAMING THE ISSUE

LINK BETWEEN ETHICAL RISK ASSESSMENT & AUDITING



1.

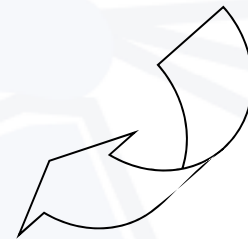
IS THERE A RELATIONSHIP BETWEEN ETHICAL RISK AND VALUE OF THE FIRM?

NO

YES

2.

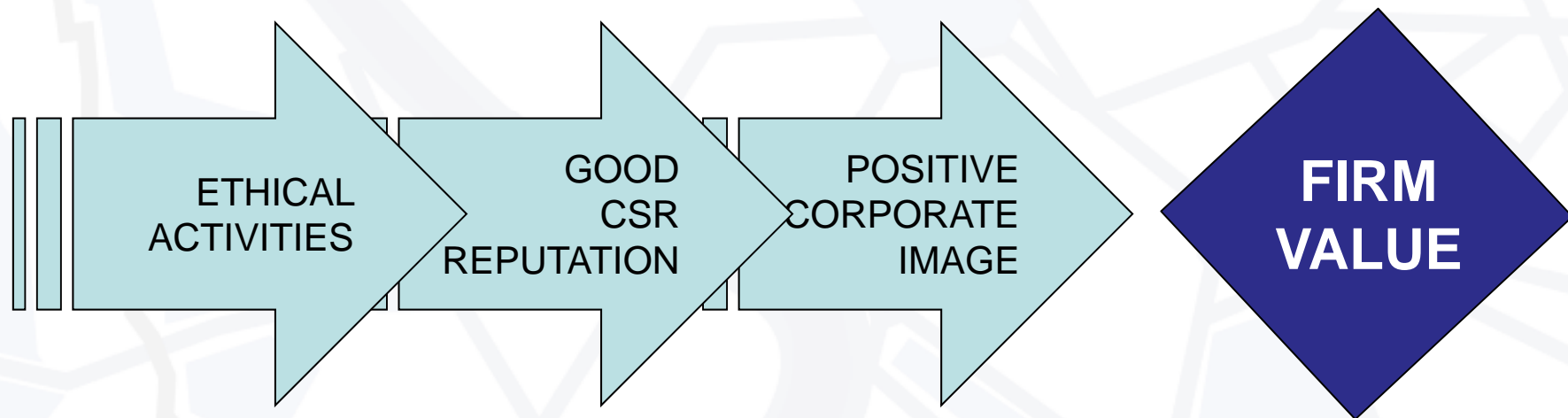
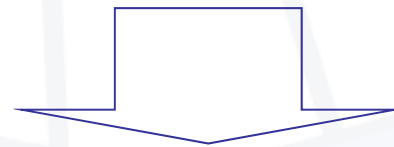
WHAT IS THE AUDITING FUNCTION?





ETHICAL RISK ASSESSMENT

Management, investors and stakeholders have become increasingly interested in evaluating companies from an ethical performance perspective





CORPORATE SOCIAL RESPONSIBILITY

Companies are increasingly required to balance the social, economic and environmental components of their business, while building shareholders' value.

Far from being a simply window dressing activity, CSR, nowadays, is seen as a value creation tool



According to the recent approaches to CSR, firms invest in social activities to exploit their potential positive effects on profits and performance

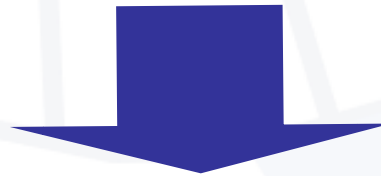
Clarkson, 1995; Waddock and Graves, 1997





CSR & FINANCIAL PERFORMANCE

The relationship between CSR and firms financial performance has become particularly relevant in the scientific literature since the 90s



STAKEHOLDER THEORY:

Companies are accountable not only to their shareholders but to stakeholders

CSR is seen as a strategic element in order to satisfy stakeholders expectations

Freeman, 1984





CSR & FINANCIAL PERFORMANCE

The literature is divided in 3 principal strands:

positive correlation
between CSR and
financial results

lack of correlation
between CSR and
financial results

negative correlation
between CSR and
financial results

CSR has a a big
return in terms of
image and overall,
financial results and
a good CSR
**simplifies the
relationship with
stakeholders**

The relationship
between CSR and
firms performance
doesn't exist.

According to
**managerial
opportunism
hypotheses**,
managers can reduce
investments in CSR
in order to increase
short term profitability



CSR & FINANCIAL PERFORMANCE

Against

- ✓ CSR is costly
- ✓ the related advantages are not really sure
- ✓ the potential financial benefits are in the distant future
- ✓ managers are not capable to determine what the social responsibility of their company is

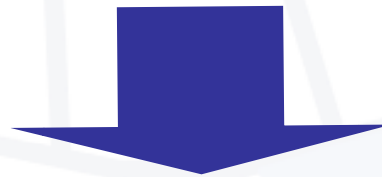
In favor

- ✓ CSR represents a way of responding to stakeholders requirements
- ✓ CSR initiatives can lead to achieve reputational advantages
- ✓ firms may engage in CSR activities in order to develop and maintain good relationships with various stakeholders



CSR & FINANCIAL PERFORMANCE

The difference between the simple communication and the real value created by CSR activities requires the measurement of their impact and the analysis of the effect registered in the financial markets.



If a link between CSR and Financial Performance exists, it will be possible to affirm that financial markets recognise to the socially responsible firms:

- ✓ higher return of the investment;
- ✓ risk reduction;
- ✓ higher potential leverage





CSR & BUSINESS ETHICS

The wave of corporate scandals that companies faced worldwide have called attention to the prevalence of serious forms of ethical misbehavior in business



SOLUTIONS PROPOSED BY THE REPUTATION INSTITUTE OF NY

Infusion of ethical principles in corporate culture

Appointment of Chief Ethics Officers

Adoption of strict ethical guidelines and codes of conduct

Fombrun and Foss, 2004





CSR & BUSINESS ETHICS

CSR, creating CORPORATE REPUTATION that acts as RESERVOIR OF GOODWILL, could create value for the firm:



Reputation serves as a signal of firm's past interactions with stakeholders and thus may be difficult to imitate

A good reputation may create economic value by improving a firm's ability to recruit and retain its primary stakeholders

Schneitz and Epstein, 2005

12





CSR & BUSINESS ETHICS

CSR can provide a vehicle for bringing ethics and values into alignment with business goals



CSR has to be seen as an intangible economic asset that contributes to a firm's sustainable competitive advantage

Barney and Hansen, 1994

Teece, 1998





ETHICAL RISK AND VALUE OF THE FIRM

**ETHICAL ACTIVITIES AND CSR POLICIES HAVE AN
IMPACT ON FIRM VALUE**



Firms have to face ETHICAL RISK:

***Risks linked to losses in reputation
due to bad Corporate Social
Responsibility policies***





ETHICAL RISK AND VALUE OF THE FIRM

1.

IS THERE A RELATIONSHIP BETWEEN ETHICAL RISK AND VALUE OF THE FIRM?

*In a long term perspective,
this relationship exists, thus*



*the next step is to analyze the auditing role
in that value creation cycle*





ETHICAL RISK AND AUDITING

If investing in Ethics adds value to the firm ...



... an effective and efficient auditing activity is required

In both terms of:

INTERNAL AUDITING

EXTERNAL AUDITING





ETHICAL RISK AND AUDITING

INTERNAL AUDITING ACTIVITIES



Focus on internal processes

At the organizational level, who is responsible for CSR activities (and communication) should be less focused on traditional external relationship functions, and more focused on the creation of value paths (intangible assets, reputation, image ...)





ETHICAL RISK AND AUDITING

INTERNAL AUDITING PROCEDURES. AN EXAMPLE: THE ENEL CASE

Ethical Audit: “audit activities consisting in assess and promote the improvement of ethic in the organization through the analysis and evaluation of ethical risk control procedures”

According to the Ethic Code (EC), the Corporate Audit Manager has to:

- ✓ *Verify the application of the EC thanks to ethical auditing processes;*
 - ✓ *Supervise the EC adoption and the awareness;*
 - ✓ *Verify the completeness and reliability of CSR Report;*
- ✓ *Propose to the Internal Control Committee EC’s integrations and modifications*





ETHICAL RISK AND AUDITING

EXTERNAL AUDITING PROCEDURES/ASSURANCES



It's very difficult to concretely think about external auditing procedures without clear, homogeneous and accepted global reporting standards.

Nevertheless, experiences as *GRI Sustainability Reporting Guidelines* provide a relevant guidance for organizations to disclose their sustainability performance.





ETHICAL RISK AND AUDITING

EXTERNAL AUDITING PROCEDURES/ASSURANCES

FORMAL ASSURANCE

Formal statements issued by independent professional assurance providers. It's the result of a systematic, evidence-based process that allows the provider to draw conclusion on the quality of the report and its data and the underlying processes

THIRDY PART COMMENTARY

Views or commentary of other external parties included in the report. The commentary may be from influential stakeholder group or reputable experts in a specialist CSR field





ETHICAL RISK AND AUDITING

ASSURANCE STANDARDS

**International Standard for
Assurance Engagements (ISAE
3000**

***Accountability Assurance
Standard 1000***

*Compulsory for accounting
firms doing corporate
responsibility assurance if
there is no national
alternative*

*Issued by the non-profit
organization AccountAbility*





ETHICAL RISK AND AUDITING

Corporate Responsibility Reporting Assurance according to KPMG International Survey of Corporate Responsibility Reporting 2008

Formal assurance increased from 30% to 40% in Global Fortune 250 Report

The same trend is registered at a national level

27% of reports contained other types of third party commentary

Less than 20% of North American companies utilize formal assurance

Mining, utilities and oil&gas sectors represent the major users of formal assurance





ETHICAL RISK AND AUDITING

Country	2002 (percent)	2005 (percent)	2008 (percent)
France	14	40	73
Spain	27	44	70
Italy	66	70	61
UK	53	53	55
Denmark	45	31	46
Netherlands	38	40	44
Australia	42	43	42
South Africa	100*	22	36
Sweden	15	5	33
Finland	29	19	30
Norway	20	33	30
Japan	26	31	24
Canada	10	10	19
USA	2	3	14

(Selected countries where historical data are available)

Source: ICRAG Global Sustainability Services, October 2008

*Only one report issued in 2002.





ETHICAL RISK AND AUDITING

**EXTERNAL AUDITING PROCEDURES.
AN EXAMPLE: ENEL CSR REPORT AND AUDITORS REVIEW**



Review carried out in accordance with:

- ✓ *the “International Standard on Assurance Engagements 3000 (ISAE 3000), issued by the International Auditing and Assurance Standard Board and*
- ✓ *the Accountability 1000 Assurance Standard, issued by AccountAbility in 2003*





ETHICAL RISK AND AUDITING

EXTERNAL AUDITING PROCEDURES. AN EXAMPLE: ENEL CSR REPORT AND AUDITORS REVIEW

Procedures performed by KPMG:

- ✓ *interviews with Enel's staff responsible for implementing the CSR program;*
- ✓ *analysis of Enel Group's main risks in relation to sustainability issues;*
- ✓ *interviews with the internal audit staff;*
- ✓ *verification on the stakeholders' involvement process;*
- ✓ *achievement of the representation letter, signed by the parent's legal representative, on the reliability and completeness of the sustainability report*





ETHICAL RISK AND AUDITING

2.

WHAT IS THE AUDITING FUNCTION?

EXTERNAL AUDITING

Necessary, but applicable only if supported by diffused and homogenous set of CSR standards (as IAS/IFRS for accounting), eventually diversified by sector.





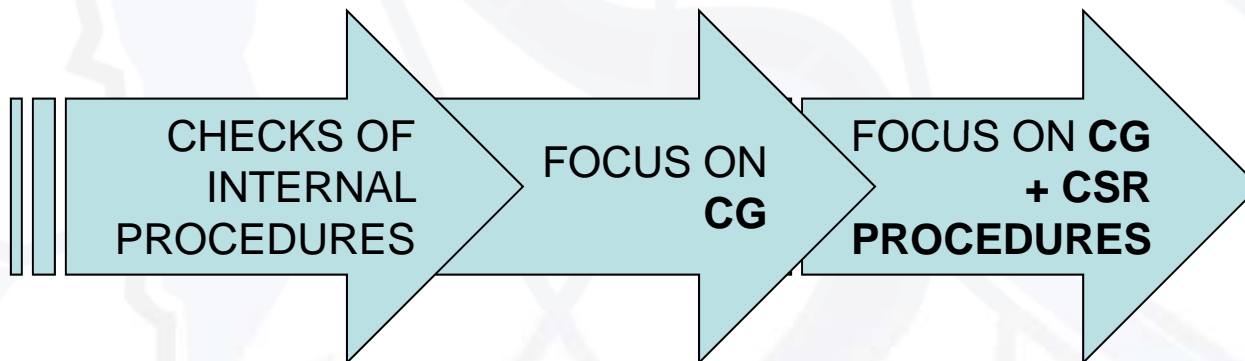
ETHICAL RISK AND AUDITING

2.

WHAT IS THE AUDITING FUNCTION?

INTERNAL AUDITING

Evolution:



*Importance of
CSR culture's
development
within the
organizations*

