



BEST PRACTICE Quality Environment

The quality environment is the totality of practices that management uses that effects how workers perform. It is the attitudes, values, ethics, policies, procedures and behavior of management that sets the example for work in the organization. For example, if management is ethical and customers over pay their accounts, they will be refunded the overpayment. If IT management recognizes that they would not have any work task to perform if not for the users, then the users will be treated as very important people and their desires would be important to the IT organization. On the other hand, if IT users are viewed as not knowing the requirements and over demanding, they will be treated as unimportant to the IT organization.

In business and accounting literature, the environment is referred to in many different ways. In accounting literature it is sometimes called the “control environment,” other times the “management environment,” and sometimes just the environment in which work is performed. What is important to understand is that the environment significantly impacts the employee’s attitude about complying with policies and procedures. For example, if IT management conveys that they do not believe that following the system development methodology is important; project personnel most likely will not follow that system development methodology. Likewise, if IT management conveys a lack of concern over security, employees will be lax in protecting their passwords and securing confidential information.

The quality environment has a pervasive influence on the way business activities are structured, objectives established, and risks assessed.

The Six Attributes of an Effective Quality Environment

Five major accounting associations (Financial Executives International, American Institute of Public Accountants, American Accounting Association, The Institute of Internal Auditors, and the Institute of Management Accountants), formed a group known as COSO (Committee of Sponsoring Organizations), to provide guidance on evaluating internal control. They issued this guidance as the COSO Internal Control Framework. The COSO Framework identified the six quality attributes. For each attribute, they listed several control objectives that if implemented would define each of the six attributes.

The six attributes are briefly described below together with the COSO control objectives for that attribute.



The following six attributes are the key attributes of an effective quality environment:

- **Integrity and Ethical Values**

Management must convey the message that integrity and ethical values cannot be compromised, and employees must receive and understand that message. Management must continually demonstrate, through words and actions, a commitment to high ethical standards. The control objectives for this attribute are:

- Existence and implementation of codes of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards of ethical and moral behavior.
- Establishment of the “tone at the top” – including explicit moral guidance about what is right and wrong – and extent of its communication throughout the organization.
- Dealings with employees, suppliers, customers, investors, creditors, insurers, competitors, and auditors, etc. (e.g., whether management conducts business on a high ethical plane, and insist that others do so, or pay little attention to ethical issues).
- Appropriateness of remedial action taken in response to departures from approved policies and procedures or violations of the code of conduct. Extent to which remedial action is communicated or otherwise becomes known throughout the entity.
- Management’s attitude towards intervention or overriding established controls.
- Pressure to meet unrealistic performance targets – particularly for short-term results – and extent to which compensation is based on achieving those performance targets.

- **Commitment to Competence**

Management must specify the level of competence needed for particular jobs, and translate the desired levels of competence into requisite knowledge and skills. The control objectives for this attribute are:

- Formal or informal job descriptions or other means of defining tasks that comprise particular jobs.



- Analyses of the knowledge and skills needed to perform jobs adequately.

- **Management's Philosophy and Operating Style**

The philosophy and operating style of management has a pervasive effect on an entity. These are, of course, intangibles, but one can look for positive or negative signs. The control objectives for this attribute are:

- Nature of business risks accepted, e.g., whether management often enters into particularly high-risk ventures, or is extremely conservative in accepting risks.
- Personnel turnover in key functions, e.g., operating, accounting, data processing, internal audit.
- Management's attitude toward the data processing and accounting functions, and concerns about the reliability of financial reporting and safeguarding of assets.
- Frequency of interaction between senior management and operating management, particularly when operating from geographically removed locations.
- Attitudes and actions towards financial reporting, including disputes over application of accounting treatments (e.g., selection of conservative versus liberal accounting policies, whether accounting principles have been misapplied, important financial information not disclosed, or records manipulated).

- **Organizational Structure**

The organizational structure shouldn't be so simple that it cannot adequately monitor the enterprise's activities nor so complex that it inhibits the necessary flow of information. Executives should adequately understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions. The control objectives for this attribute are:

- Appropriateness of the entity's organizational structure, and its ability to provide the necessary information flow to manage its activities.



- Adequacy of definition of key managers' responsibilities, and their understanding of these responsibilities.
- Adequacy of knowledge and experience of key managers in light of responsibilities.
- Appropriateness of reporting relationships.
- Extent to which modifications to the organizational structure are made in light of changed conditions.

- **Assignment of Authority and Responsibility**

The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and sets forth-respective roles in the organization. The control objectives for this attribute are:

- Assignment of responsibility and delegation of authority to deal with organizational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorization for changes.
- Appropriateness of control-related standards and procedures, including employee job descriptions.
- Appropriate numbers of people, particularly with respect to data processing and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems.
- Appropriateness of delegated authority in relation to assigned responsibilities.

- **Human Resource Policies and Practices**

Human resource policies are central to recruiting and retaining competent people to enable the entity's plans to be carried out so its goals can be achieved. The control objectives for this attribute are:

- Extent to which policies and procedures for hiring, training, promoting and compensating employees are in place.



- Appropriateness of remedial action taken in response to departures from approved policies and procedures.
- Extent to which personnel policies address adherence to appropriate ethical and moral standards.
- Adequacy of employee candidate background checks, particularly with regard to prior actions or activities considered to be unacceptable by the entity.
- Adequacy of employee retention and promotion criteria and information-gathering techniques (e.g., performance evaluations) and relation to the code of conduct or other behavioral guidelines.

References

Guide – CSQA Common Body Of Knowledge, V6.2