

Where Ethics, Integrity & Audit Intersect

Challenges & Actions for Auditors

Session W-303

The Conference That Counts
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Internal Auditor – October 2005

Ethics as a Strategy

Successful ethics programs consist of a process that incorporates analysis of outcomes and continual improvement.

BY DAVID CHILDERS

THE CONCEPT OF ETHICS AS an integral component of business strategy was thrust into the spotlight with the Enron-led wave of governance disasters and the passage of the U.S. Sarbanes-Oxley Act of 2002. In the three years since Sarbanes-Oxley was enacted, scandals continue to surface and organizations around the globe are facing new mandates, standards, and increased stakeholder expectations. They are being challenged to address these issues in a way that supports performance objectives, sustains value, and protects the organization's reputation.

Many organizations are approaching these challenges by examining ways to strengthen their cultural underpinnings. By fostering a strong ethical culture, firms are better able to gain the confidence and loyalty of their employees and other stakeholders, which can result in reduced financial, legal, and reputational risk, as well as improvements in orga-

helps ensure compliance and deters fraud and abuse, ultimately increasing organizational effectiveness and value.

Elements of these programs that can help build stronger ethical cultures include:

- *Analyzing the risk factors inherent throughout the organization.* Each organization has unique operational and environmental issues that influence its risk profile. Risk factor analysis entails capturing input from employees and other key stakeholders and carefully examining the processes and procedures currently in place. For multinational organizations, this also requires an understanding of the cultural norms and behavior patterns of the organization's overall workforce.
- *Developing guidelines, processes, and standards that engage the identified risk factors.* Armed with the appreciation of risk factors, organizations can take the proactive approach of building an ethics and compliance



Preaching to the Converted

JOHN J. HALL

JOHN J. HALL

JOHN J. HALL

Presenter's Point of View

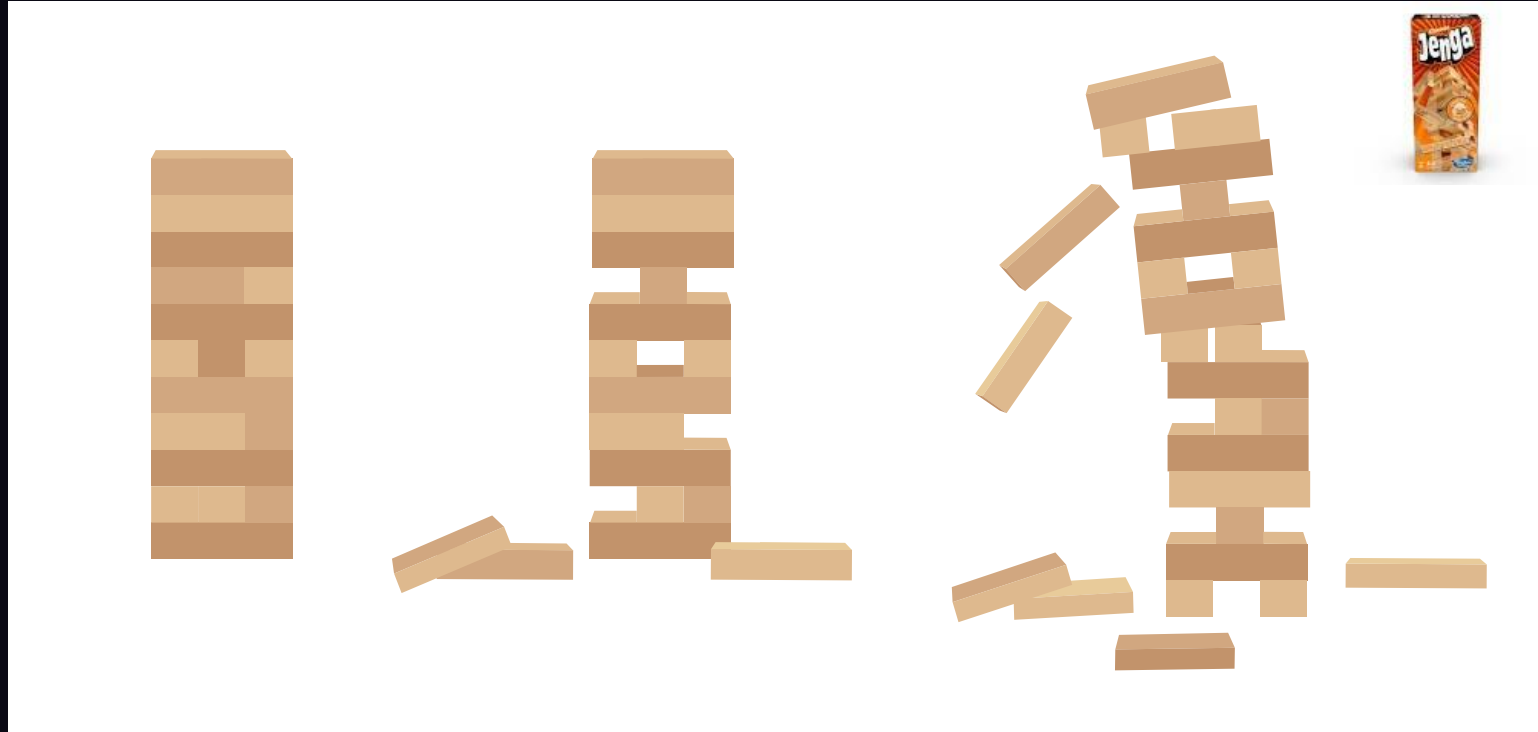
(and advance apology for Preaching)

**It's a few – not most
But those few
are causing great harm**

SIMPLE ANSWER

All business
organizations are
founded on trust...
*and any deception
undermines trust*

The Jenga Credibility Challenge



Starting Point

Related But Not Identical

INTENTIONS



ETHICS

A philosophical discipline that
describes and directs moral conduct

Ethics – Two Categories

Personal

Individual's basic notion of right and wrong

Organizational

Consciously defined by organizations to promote consistent integrity in the members

Related But Not Identical

INTENTIONS

ETHICS

A philosophical discipline that describes and directs moral conduct

ACTIONS

INTEGRITY

Consistent and uncompromising adherence to strong moral and ethical principles and values

The Slippery Slope

**Integrity
Erosion**

Integrity Scale

Unethical
(Dishonest)



Ethical
(Honest)

Integrity Scale

2%

Unethical
(Dishonest)

53%

45%

Ethical
(Honest)

*Well...
It Depends*

Here's A Case

How would you handle this?

Existing apartment building renovation

Drywall (critical path work)

Behind schedule

Two drywall subs already fired

Miracle solution presented to you

Here's Another Case

How would you handle this?

Apartment buildings to be demolished due to storm

Insurance claim filed

Functioning kitchen appliances removed

Copper pipes removed from walls

A/C units removed

Maintenance staff disappears

Just One More Case for Now

How would you handle this?

A manager entertains a foreign government official

Expense report shows 'business lunch' for \$2,800

Government official approves long-delayed

zoning change request two weeks later

Internal audit team is told by CEO to drop

expense report finding from draft report

Integrity Scale

2%

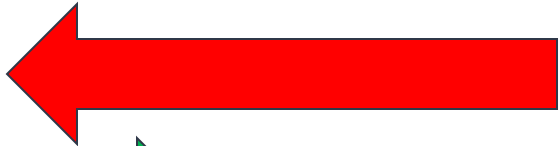
Unethical
(Dishonest)

53%

45%

Ethical
(Honest)

*Well...
It Depends*



Integrity Scale

Unethical



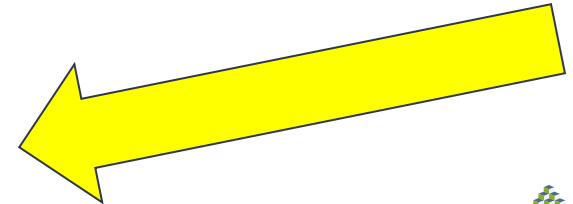
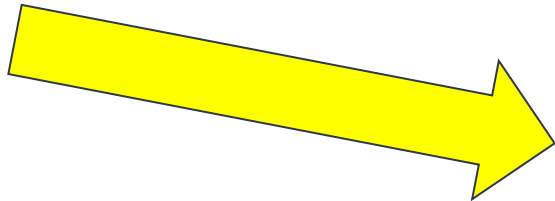
Ethical



Pressure

Opportunity

Rationalization



Related But Not Identical

INTENTIONS

ETHICS

A philosophical discipline that describes and directs moral conduct

ACTIONS

INTEGRITY

Consistent and uncompromising adherence to strong moral and ethical principles and values

RATIONALIZATION

Ethics / Integrity Disconnect Risk

Related But Not Identical

INTENTIONS

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A philosophical discipline that describes and directs moral conduct

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Consistent and uncompromising adherence to strong moral and ethical principles and values

VERIFICATION

COMPLIANCE

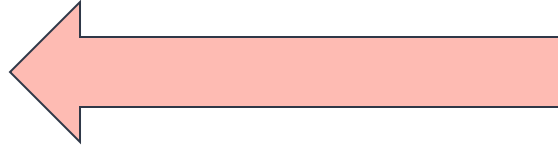
A legal discipline that describes rules by which we determine whether or not actions are acceptable

Integrity Scale

Unethical
(Dishonest)



Ethical
(Honest)



- ✓ **Governance**
- ✓ **Policies**
- ✓ **Internal Controls**
- ✓ **Tone 'In The Middle'**
- ✓ **Micro Culture**

Whack a Mole



Too Many Moles – Not Enough Mallets

Related But Not Identical

INTENTIONS

ETHICS

A philosophical discipline that describes and directs moral conduct

ACTIONS

INTEGRITY

Consistent and uncompromising adherence to strong moral and ethical principles and values

VERIFICATION

COMPLIANCE

A legal discipline that describes rules by which we determine whether or not actions are acceptable

ACCOUNTABILITY

Accountability Disconnect

#1 Question

**What Role
Does Fear of
Punishment Play?**

Six Business Ethics Filters

1. What are the rules?
2. What are my beliefs about the rules?
3. What is my 'micro context'?
4. Will I get caught?
5. Will I get punished?
6. How severe is the punishment?

A	B	C	D	E	F
	Permitted, But Not Encouraged	Warning	Loss of Job	Report to Authorities	Notes
Item	(1)	(2)	(3)	(4)	
A					
B					
C					
D					
E					
F					
G					
H					

Case Situation A

An employee commits fraud by overstating out of pocket travel expenses to cover a \$25.00 lost wager with a supplier on a football game.

Case Situation B

An employee commits fraud by overstating out of pocket travel expenses by \$100.00 to cover of drinks while on a business trip.

The organization's policy prohibits reimbursement for alcohol.

Case Situation C

Setting up and authorizing payments to a fictitious vendor for goods or serviced never received.

Case Situation D

Having a vendor divide a \$98,000 equipment purchase into four equal invoices of \$24,500 each, so that each invoice will fall below the requesting manager's approval level of \$25,000.

Case Situation E

Ordering maintenance supplies from a specific vendor because that vendor gives gifts and prizes directly to the ordering employee.

The price and quality are comparable to what is available from other vendors.

Case Situation F

Ordering maintenance supplies from a specific vendor because that vendor gives gifts and prizes directly to the ordering employee.

The prices are high and quality is poor compared to what is available from other vendors.

Case Situation G

Intentionally altering division-level accruals and reserves at the end of an accounting period specifically to 'manage income' to headquarters expectations.

Case Situation H

After being hired, it's discovered that our new employee does not have the required education, experience or certified training required for the job.

Case Situation I

After being hired, it's discovered that our new employee does not have the required education, experience or certified training required for the job.

The employee is an aircraft engine mechanic.

Case Situation J

Soliciting and receiving a 2% kickback from a major raw materials supplier on all orders placed with the supplier.

A	B	C	D	E	F
	Permitted, But Not Encouraged	Warning	Loss of Job	Report to Authorities	
Item	(1)	(2)	(3)	(4)	Notes
A					
B					
C					
D					
E					
F					
G					
H					

The Good-Old Four-Legged Stool Model



Ethics in Principle



Integrity in Action



Compliance Monitoring



Real Accountability

The Four-Legged Stool

***“The structure
beneath the surface
they see...”***

***That's great in
theory, but...***

Question?

***What happens
if one leg is
broken or missing?***

What if two legs...

30 Minute Internet Search

***Case after Case
after Case...***

Former Yale Official Admits to \$40 Million Fraud Scheme

For a decade, a Yale School of Medicine administrator used university funds to buy computer equipment, which she resold to pay for luxury cars, real estate and vacations, the authorities said.



By Neil Vigdor



Give this article



278

April 1, 2022



The administrator admitted that she had submitted thousands of purchase orders for computer devices and tablets. Christopher Capozziello for The New York Times

Siblings Sent to Prison in Laptop Theft Scheme That Cost Stanford Millions

Patricia Castaneda, who stole and sold Apple MacBooks she'd bought on behalf of the institution, was sentenced to 33 months, prosecutors said. Her brother Eric Castaneda was sentenced to 18 months.

The New York Times

By Alyssa Lukpat

April 20, 2022

Former U.A.W. President Gary Jones Pleads Guilty

Mr. Jones, who was accused of embezzling \$1 million, will cooperate with federal prosecutors who have been investigating corruption at the autoworkers union.



Gary Jones, the former president of the United Auto Workers union, acknowledged using more than \$1 million in union funds for himself. ©R. Pughano/Getty Images

By Neal E. Boudette

June 3, 2020



Kraft Heinz will pay \$62 million to settle accusations of an accounting 'scheme.'

By Lauren Hirsch

Sept. 3, 2021



Kraft Heinz was accused by the Securities and Exchange Commission of inflating its cost savings. Nam Y. Huh/Associated Press

The New York Times

Equipment Rent v. Buy



Rent for \$85/month or Buy for \$265

Equipment Rent v. Buy



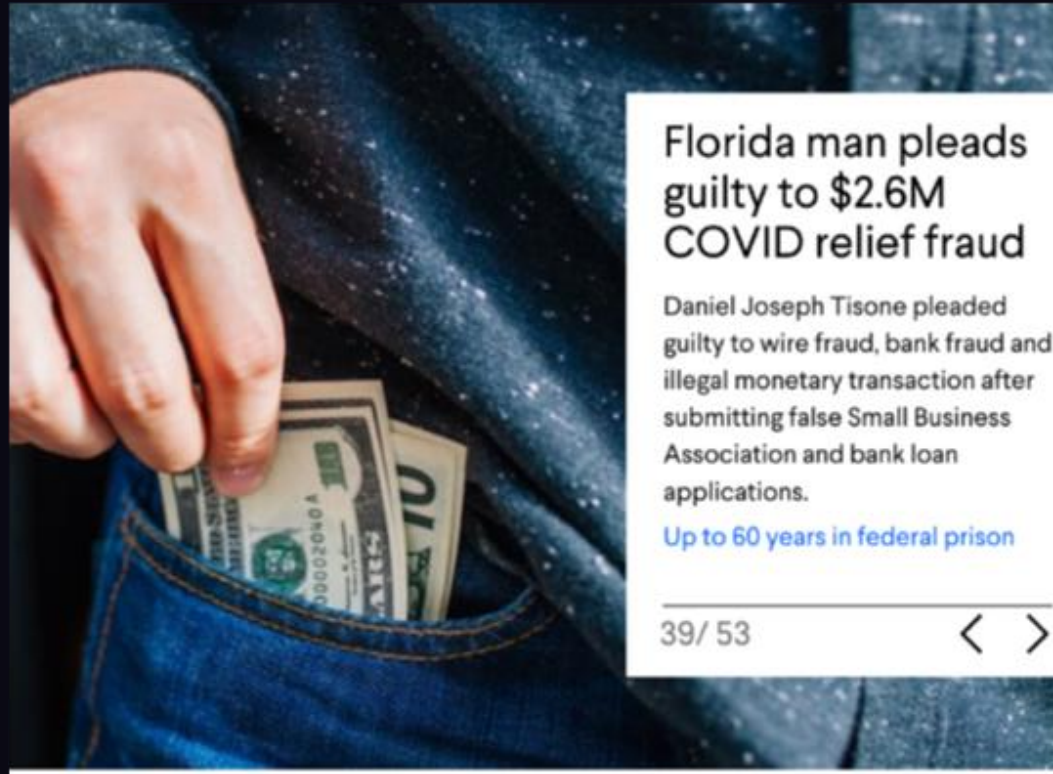
Rent for \$775/month or Buy for \$11,500



I Keep Wondering...

***Why do intelligent
business people stare
right into the face of ethics –
and then do
the wrong thing anyway?***

Oh Yeah – And The Public, Too



Florida man pleads guilty to \$2.6M COVID relief fraud

Daniel Joseph Tisone pleaded guilty to wire fraud, bank fraud and illegal monetary transaction after submitting false Small Business Association and bank loan applications.

[Up to 60 years in federal prison](#)

39/ 53



A Question from Way Out There

**Are we fooling ourselves
believing ethical principles
make a real difference in
business decisions?**

Possible Conclusion

*Maybe what's
in place today
simply isn't working*

***Are we applying
yesterday's logic
to today's issues?***

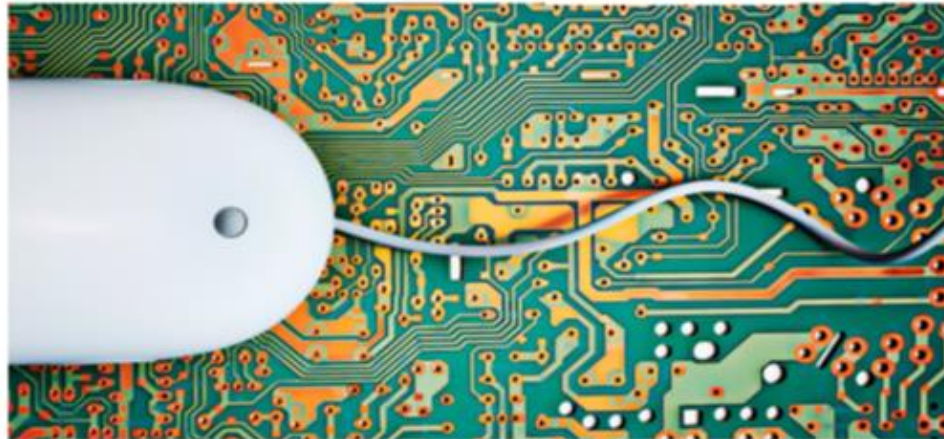
Pay the Ransom?

Ransomware Attacks Are Spiking. Is Your Company Prepared?

by Brenda R. Sharton

May 20, 2021

**Harvard
Business
Review**



David Muir/Getty Images

Environmental Impact vs. Profits?

The Effects of Air Pollution on Business Performance

Written by [Cassandra Garrett](#) on April 19, 2021. Posted in [Articles](#), [Organisational performance](#)



Nearly three years ago, in November of 2018, leaders and academics from around the world made an appearance at the World Health Organization's inaugural [Global Conference on Air Pollution and Health](#); no corporate leaders, however, were present for the event.

Have the Anticapitalists Reached Harvard Business School?

Social justice joins discounted cash flows on the syllabus as essential knowledge for aspiring corporate leaders.



By Emma Goldberg

Nov. 28, 2022, 3:00 a.m. ET



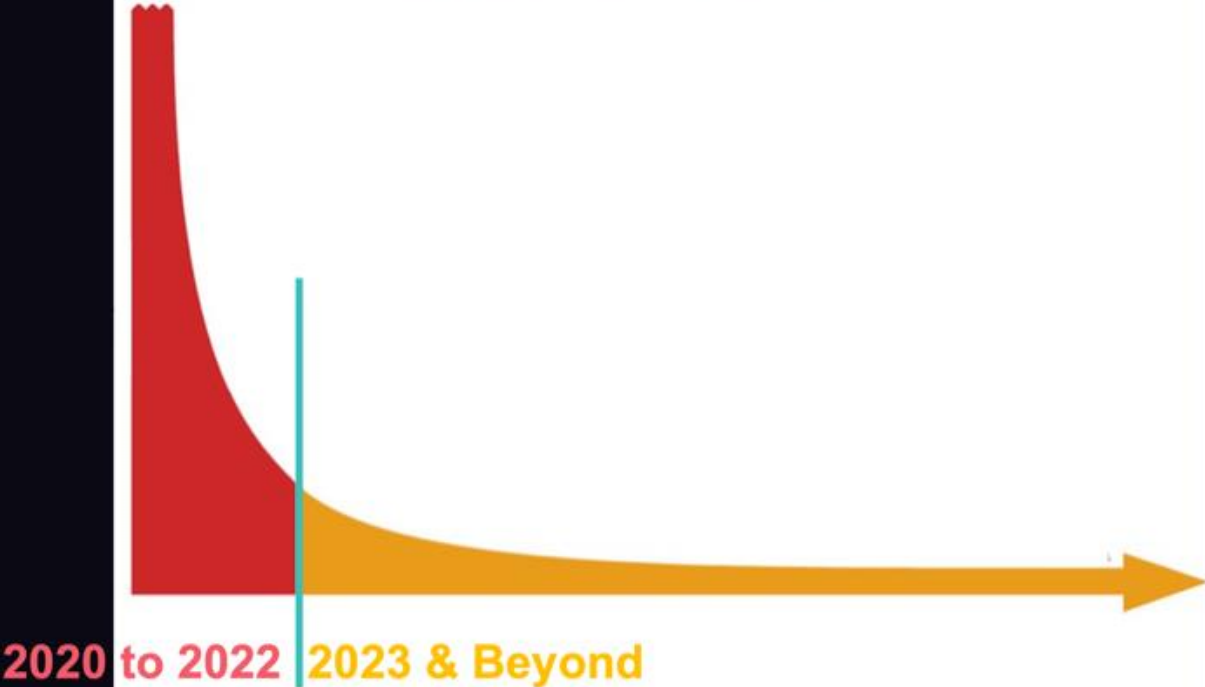
The Wharton School of the University of Pennsylvania will start offering M.B.A. majors in diversity, equity and inclusion and in environmental, social and governance factors for business next fall. Hannah Yoon for The New York Times

Ethical Dilemma

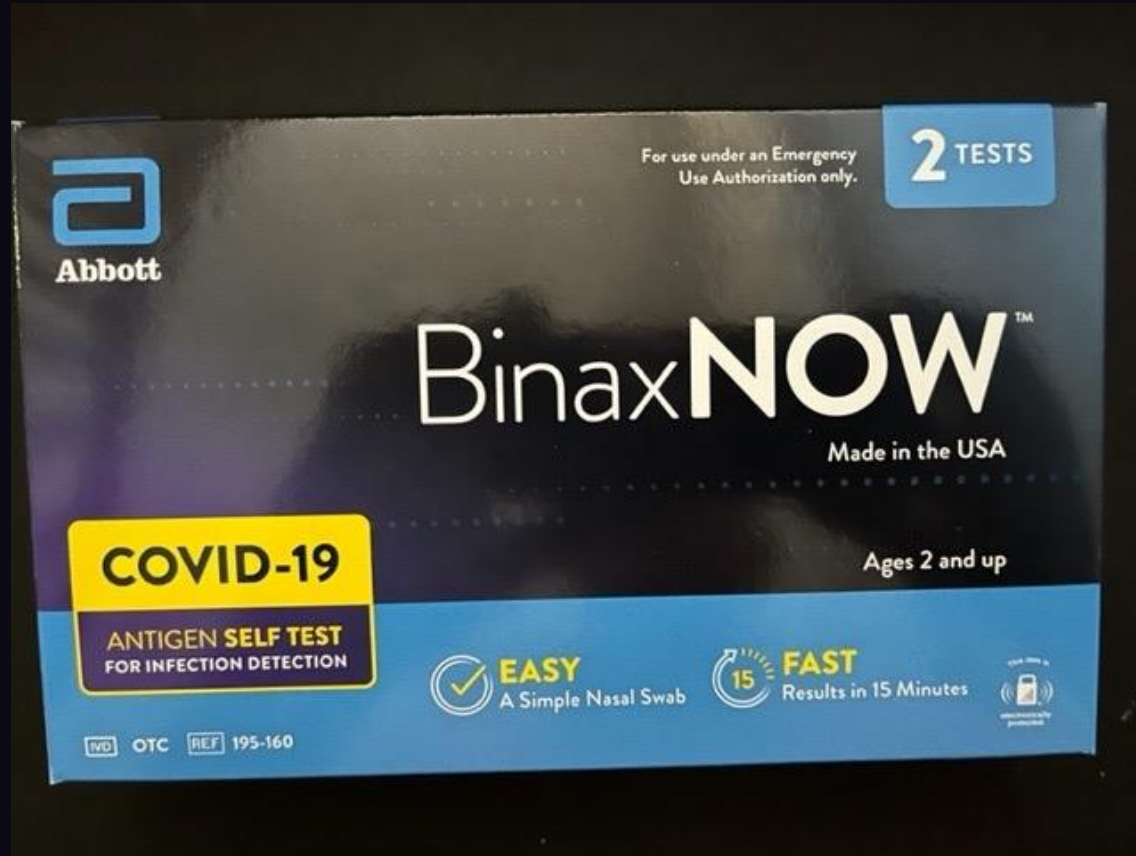
**Difficulty arises not from ignorance
about what is right or wrong,
but rather from being forced to choose
from a flawed set of options**

Good People with Bad Options

Covid Tail



COVID Self-Test Results



Question

Away on business all week – a two-hour flight from home.
Thursday evening, you feel lousy.
You buy a Covid self-test kit and it comes up ‘positive’.
Do you get on the 7AM flight home on Friday morning?

1. Yes, but don't breathe on other people during the flight.
2. Yes, but wear four masks.
3. No. Rent a car and drive home.
4. No. Quarantine in your hotel room until negative test result.
5. Other

Question

You've been on a Covid-delayed two-week vacation to Spain. The day before returning home, you feel lousy. You buy a Covid self-test kit and it comes up 'positive'. Do you get on the 7AM flight home the next morning?

- 1. Yes, but don't breathe on others during the flight.**
- 2. Yes, but wear four masks.**
- 3. No. Buy a row boat and paddle home to North America.**
- 4. No. Quarantine in your hotel room until negative test result.**
- 5. No. Buy a home in Barcelona & have your family ship your stuff.**
- 6. Other**

Off-Site Employee Monitoring



Time Reporting



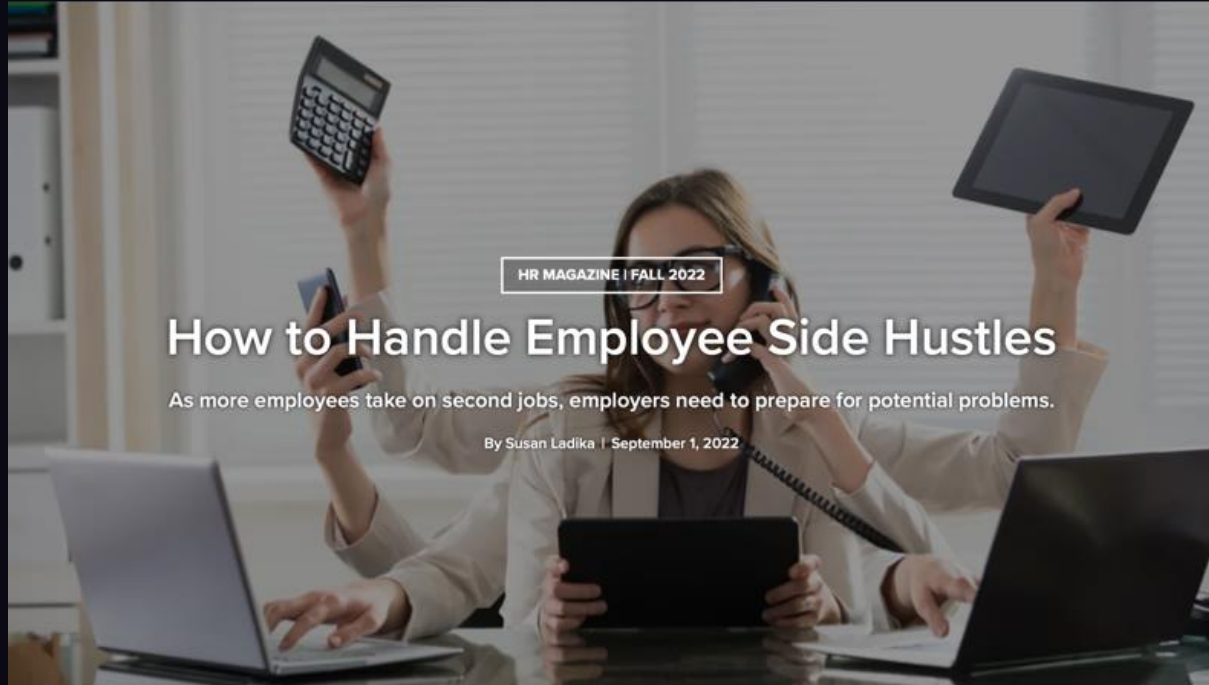
Out of Pocket Reimbursement



Conflict of Interest



Undisclosed Side Business



HR MAGAZINE | FALL 2022

How to Handle Employee Side Hustles

As more employees take on second jobs, employers need to prepare for potential problems.

By Susan Ladika | September 1, 2022

Reporting Suspicions? – Maybe...



Question

Do you feel that employee ethics training is effective in influencing day to day behavior?

Yes

No

Ernst & Young to Pay \$100 Million Fine After Auditors Cheated on Ethics Exams

The S.E.C. said the cheating involved hundreds of the firm's workers from 2017 to 2021, resulting in the largest penalty ever imposed by the agency against an auditing firm.



Give this article



"It's simply outrageous that the very professionals responsible for catching cheating by clients cheated on ethics exams of all things," said Gurbir S. Grewal, the S.E.C.'s director of enforcement. Jack Taylor/Getty Images



By **Matthew Goldstein**

June 28, 2022

EY agrees to pay \$100 million fine to settle SEC investigation into ethics exam cheating



Elisabeth Buchwald

USA TODAY

Published 3:32 p.m. ET June 28, 2022 | Updated 3:39 p.m. ET June 28, 2022



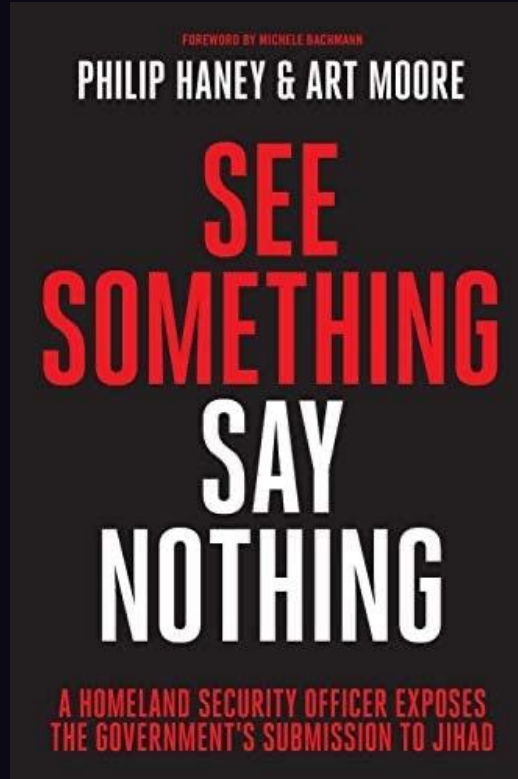
The SEC investigation, which began in 2019, found that from 2017 to 2021 at least 49 EY auditors sent and/or received answers keys to CPA ethics exams. Additionally, "hundreds" of other auditors cheated on continuing professional education (CPE) courses that are required to maintain CPA status.

This is not the first cheating scandal for the Big Four accounting firm.

From 2012 to 2015 some 200 EY auditors "exploited a software flaw in EY's CPE testing platform to pass exams while answering only a low percentage of questions correctly," according to the SEC. "The firm took disciplinary actions and repeatedly warned its audit professionals not to cheat on exams."

"And a significant number of EY professionals who did not cheat themselves, but knew their colleagues were cheating and facilitating cheating, violated the firm's Code of Conduct by failing to report this misconduct," the SEC said in findings published Tuesday.

Report Suspicions? – Maybe Not...



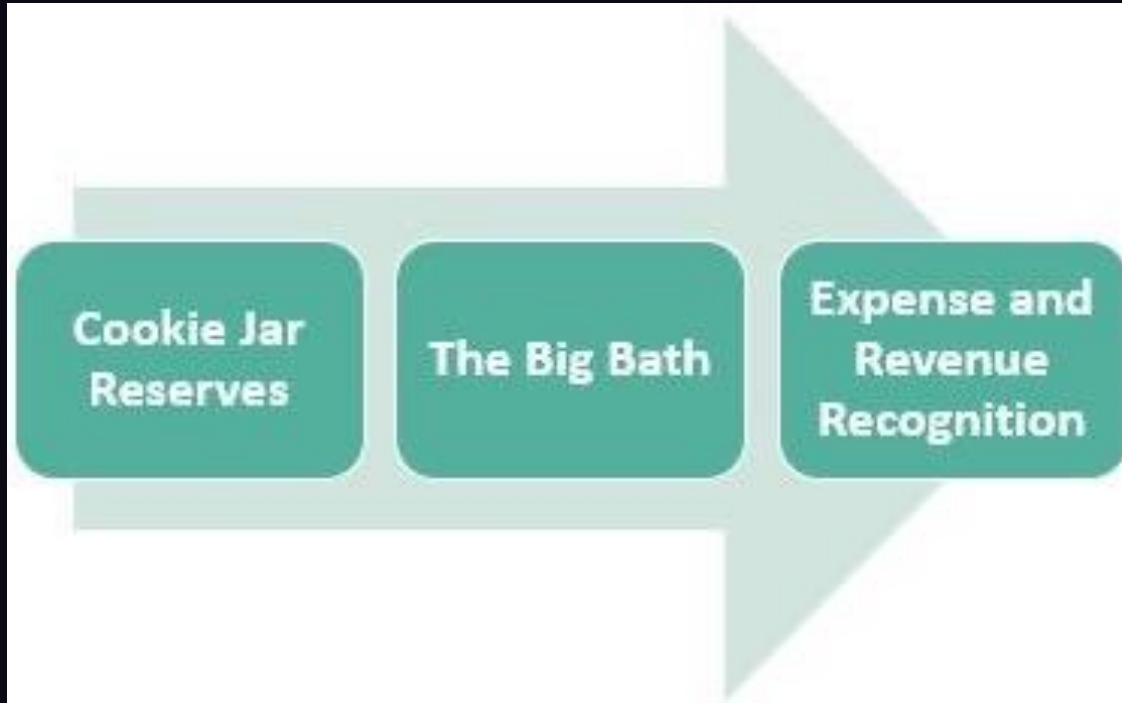
Why People Don't Speak Up

1. **It's none of my business**
2. **It's not my job!**
3. **Schoolyard mindset**
4. **Fear**
5. **There's no upside for me – only problems**
6. **I won't fit in anymore**
7. **They have never been told to do so**
8. **They have never been asked to do so**

Earnings Management



Earnings Management



What About Materiality?

Information is material if omitting, misstating or obscuring it could reasonably be expected to *influence the decisions* that primary users of general-purpose financial statements make on the basis of those financial statements.



Results Manipulation

I Ask – Again...

**Why do intelligent
people stare right into
the face of ethics –
and then
do the wrong thing anyway?**

***Looking to the
short and long
term future***

Customer Experience Promises



Workplace Discrimination



Artificial Intelligence & Algorithms



Allocation of Limited Medical Care

Undocumented Workers



Undocumented Workers – Example States

New Jersey	294,000	6.5%
New Mexico	34,000	3.7%
New York	474,500	4.9%
North Carolina	214,900	4.3%
North Dakota	4,600*	1.1%
Ohio	63,400	1.1%
Oklahoma	60,300	3.3%
Oregon	74,500	3.7%
Pennsylvania	114,000	1.8%
Rhode Island	16,100	3.0%
South Carolina	57,600	2.4%
South Dakota	5,100	1.1%
Tennessee	90,400	2.8%
Texas	1,159,000	8.4%
Utah	69,100	4.4%
Vermont	2,900*	0.9%
Virginia	191,000	4.4%
Washington	189,400	5.0%
West Virginia	2,100*	0.3%
Wisconsin	51,900	1.7%
Wyoming	4,300*	1.5%
United States	7,001,000	4.4%

Religion in the Workplace



***The Big Question:
What's Our Role***

The Good-Old Four-Legged Stool Model



Ethics in Principle



Integrity in Action



Compliance Monitoring



Real Accountability

Coming Down that Road



Client, Career & Safety Risk

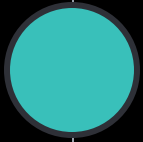
OUR ROLE

Independent

Objective

Skeptical

Instructive?



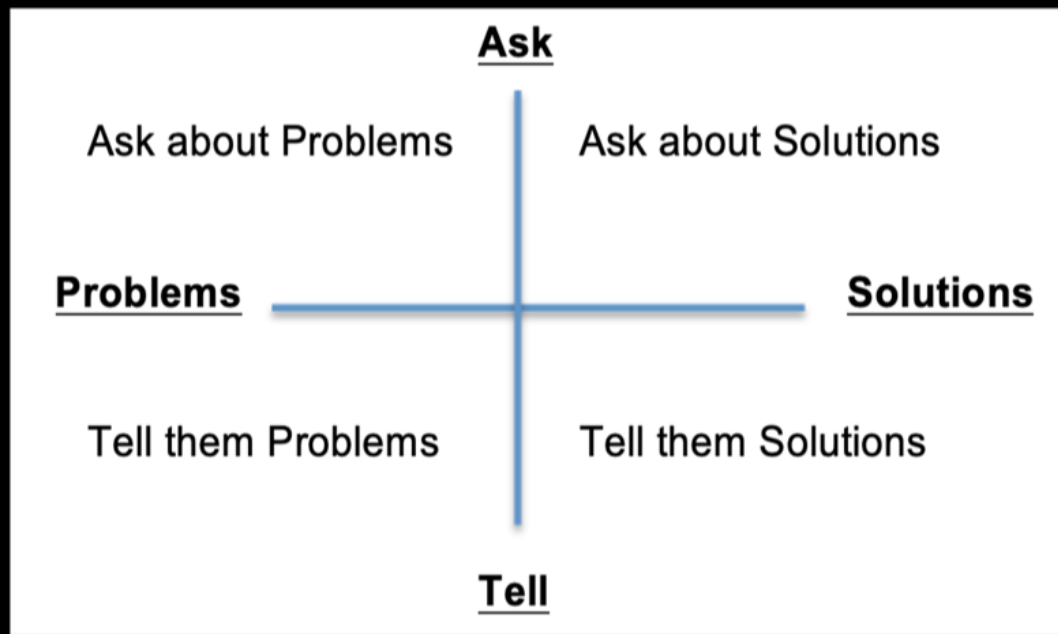
OUR ROLE

**Don't Tell Others
What to Think**

OUR ROLE

**ASK Others
What to Think
ABOUT**

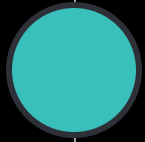
Ask About Solutions




MICRO
Assessment
Questions

Good Question

“Have you seen
anything that made
you uncomfortable”



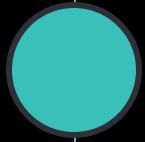
Good Question



“Have you been asked
to sign or approve anything
that you weren’t
confident was correct”

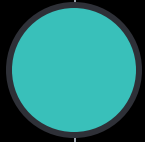
Good Question

“Is anyone
breaking the rules”



Four Magic Words

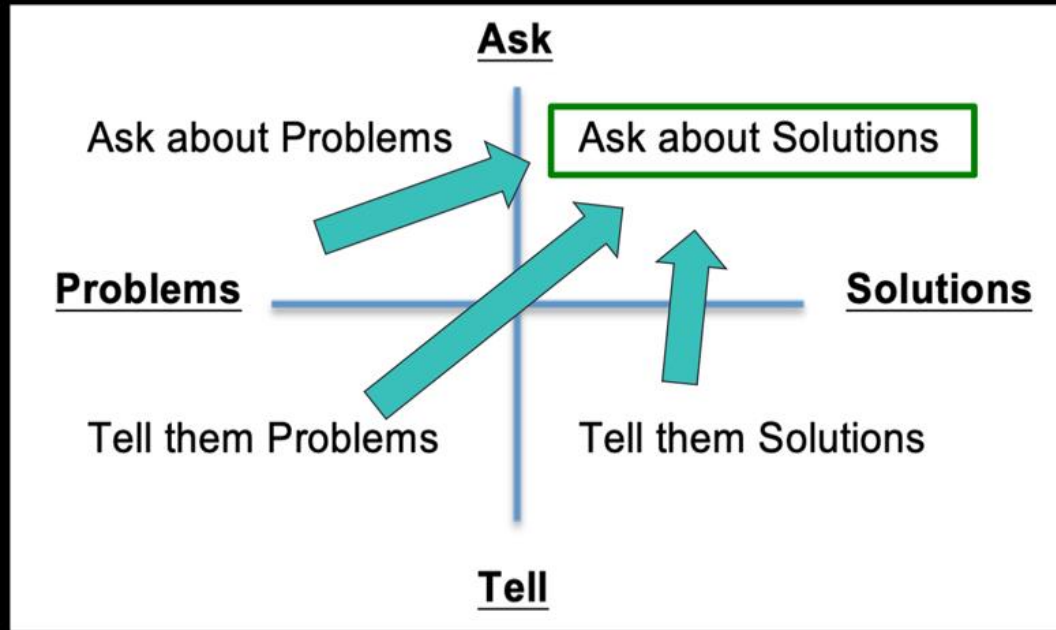
“Tell me
what happened”



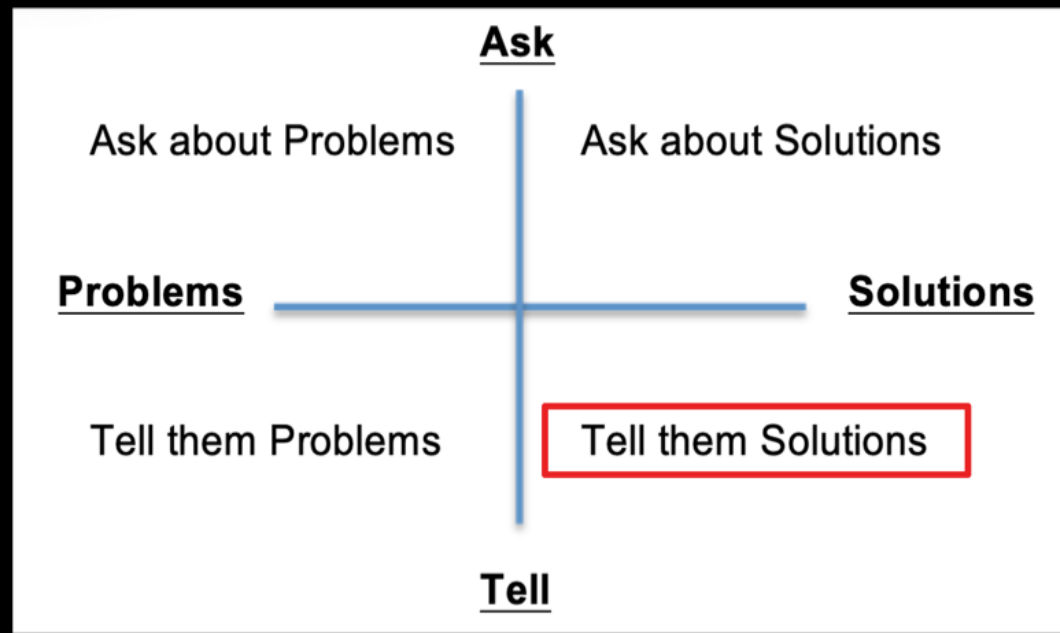
Powerful Follow-Up Question

“How could
we prove that?”

Ask About Solutions



Tell Them Solutions



ONLY WHEN ASKED



Preaching to the Converted

JOHN J. HALL


JOHN J. HALL

Ethics in a Post-Truth World



**In a time of
universal deceit,
telling the truth is a
revolutionary act.**

- George Orwell

Ethics Manifesto

Together

– on our watch –

we will no longer tolerate

**Lies, Deception,
Wrongdoing, Misconduct,
Theft, or Outright Fraud**

**One Million
Baby Steps
in the right direction
is a
MOVEMENT**



Do
what you
can,
with
what you
have,
where
you are.

—

THEODORE ROOSEVELT

**Questions, Comments, Confessions,
1-on-1 Discussion, or Anything Else**

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