

Yellow Book:

Internal Controls, Ethics, and Fraud



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Learning Objectives



- Define internal controls, fraud and ethics as utilized in the Yellow Book
- Explain ethics from varied sources
- Identify and discuss ethical dilemmas
- Demonstrate an understanding of how ethical values vary by individual

Yellow Book 6.19 Internal Control Definition

- Effectiveness and efficiency of program operations
- Relevance and reliability of information
- Compliance with applicable laws, regulations, contracts, and grant agreements



Yellow Book 6.30 Fraud Definition



- Fraud involves obtaining something of value through willful misrepresentation
- Determining whether an act is fraud is beyond the auditor's responsibility
- Fraud risks significant to audit objectives should be discussed

Yellow Book Appendix: Internal Controls and Fraud

- A.03 The Internal Control-Integrated Framework
- A.04 Standards for Internal Control in the Federal Government (Green Book)
- A.06 Examples of Deficiencies in Internal Control
- A.07 Examples of Abuse
- A.09 Examples of Indicators of Fraud Risk

Auditors and Ethics



- Yellow Book
- Institute of Internal Auditors
- Association of Certified Fraud Examiners
- Annual Ethics Exam

Ethics Definitions



- The ground rules by which we live our lives
- Learning what is right or wrong, and then doing the right thing
- The set of rules, principles, or ways of thinking that guide the actions of a group
- A system of moral principles, as in the ethics of a culture; or the moral principles of an individual, such as: Her ethics would not allow her to betray her confidential source

Morals vs. Ethics



- Ethics & Morality stem from word *Customs*
 - Ethics = Greek term 'ethos'
 - Morality = Latin root 'mores'
- Morals: personal character
- Ethics: group code of behavior
- Ethical guideline today - regulation tomorrow

Institute of Internal Auditors Principles

- Integrity: Establish trust
- Objectivity: Refrain from your own interest
- Confidentiality: Don't disclose information
- Competency: knowledge, skills, & abilities

Institute of Internal Auditors Rules of Conduct

- Integrity:
Be honest, observe law, refrain from illegal activity
- Objectivity:
Avoid things that would bias you, don't accept gifts
- Confidentiality:
Protect confidential info
- Competency:
Have appropriate knowledge, skills, & abilities

Certified Fraud Examiners Code of Ethics

- Professionalism and diligence
- Illegal/unethical conduct; conflict of interest
- Integrity and professional competence
- Comply with court orders
- Evidence for opinions
- Confidential information
- Reveal material matters
- Increase competence and effectiveness



Government Auditing Standards (The Yellow Book)

1.10-1.24

Ethical Principles in Government Auditing



Ethical Principles

■ Ethical principles for:

- Foundation
- Discipline
- Structure & Climate



- ### ■ Auditors may also be subject to ethical requirements of professional organizations, such as the IIA, CFE, and AICPA Codes of Ethical Conduct

Intro to Ethics in Yellow Book

- ### ■ The public expects audit organizations and auditors who conduct their work in accordance with GAGAS to follow ethical principles

- ### ■ Management sets the tone for ethical behavior by maintaining an ethical culture, communicating acceptable behavior and expectations to each employee, and creating an environment that reinforces and encourages ethical behavior

Conducting Audit Work With Ethical Principles

■ Ethical principles relate to the following:

- preserving auditor independence
- taking on only work that the auditor is competent to perform
- performing high-quality work
- following the applicable standards cited in the audit report

Ethical Principles (cont.)

- Ethical principles that guide auditors who perform audits in accordance w/GAGAS:
 - the public interest
 - integrity
 - objectivity
 - proper use of government information, resources, and position
 - professional behavior

The Public Interest

- Definition: The collective well-being of the community the auditors serve
- Auditors should observe integrity, objectivity, and independence in their professional responsibilities
- These principles are fundamental & critical in the government environment

Integrity

- Integrity occurs when auditors conduct their work with an attitude that is:
 - objective
 - fact-based
 - nonpartisan
 - non-ideological
- Performing audit responsibilities with integrity helps to maintain public confidence in government



Integrity (cont.)

- Making decisions consistent with the public interest is an important part of the principle of integrity
- Be aware of pressures from the audited entity, or to wrongly achieve personal or organizational gain

Objectivity

- The credibility of government auditing is based on auditor objectivity, including:
 - being independent in fact and appearance
 - maintaining an attitude of impartiality
 - having intellectual honesty
 - being free of conflicts of interest
- Maintaining objectivity includes assessing relationships with audited entities in the context of the auditors' responsibility to the public

Proper Use of Government Info, Resources, & Position

- Never use gov't info, resources, or positions for personal gain or in a manner against the law
- The public's right to the transparency of gov't info has to be balanced with the proper use
- The auditor must exercise discretion
 - Ex: do not disclose audit info to 3rd parties

Proper Use of Gov't Info, Resources, and Position (cont.)

- An auditor's proper use and sensible management of resources is essential
- The public expects auditors to protect and conserve government resources and use them appropriately

Proper Use of Gov't Info, Resources, and Position (cont.)

- Misusing your position for personal gain violates your fundamental responsibilities
- An auditor's credibility can be damaged by actions that a third party could perceive as improperly benefiting the personal financial interests of the auditor, a family member, or a related organization

Professional Behavior

- Auditors are held to high expectations, including:
 - compliance with laws and regulations
 - avoiding conduct that might discredit work
 - actions that would cause a third party to conclude the auditor's work was professionally deficient
- Includes an honest effort performing duties and professional services in accordance with the relevant technical and professional standards

Ethical Behavior Research

- Lawrence Kohlberg
- Theory based on work of Jean Piaget
- Heinz dilemma
“Would you steal medicine if needed for a family member and you had no money?”

Ethical Behavior Exercise

Question:

Should Heinz have broken into the store to steal the drug for his wife?

Why or why not?

Ethical Behavior Exercise

Ethical Behavior Quiz

SUMMARY



- Yellow Book definitions
- Codes of ethics:
 - IIA, CFE, Yellow Book
- Ethics theory: Lawrence Kohlberg
- Ethics quiz

Thank you for your time!

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