2019 NACA CONFERENCE

Park MGM ~ Las Vegas
September 9 - 11, 2019
To present concepts of ethics, fairness and objectivity as it relates to a construction auditor’s role
WHAT IS AN AUDITOR’S FUNCTION?

An auditor’s primary function is to provide a systematic and independent examination of data, records, operations and performances of an operation or enterprise for a stated purpose.
Auditing should be a TOOL and not a WEAPON!
CODE OF ETHICS

- The Short Guide to Auditing Ethics
  - Be Honest
  - Be Fair
  - Be Diligent
- Expanded explanations
  - Maintain Independence
  - Maintain Confidentiality
  - Maintain Integrity
CODE OF ETHICS

NACA Code of Professional Ethics

All National Association of Construction Auditors members must exemplify the highest moral and ethical standards and must agree to abide by the bylaws of the NACA and shall:

• Exhibit the highest level of integrity in the performance of all professional assignments;
• Demonstrate, at all times, a commitment to professionalism and diligence in the performance of his or her duties, including during the supervision of any subordinates;
• Not engage in any illegal or unethical conduct;
• Not engage in any activity which would constitute a conflict of interest, or bring discredit to the Association;
• Not hide unlawful acts discovered through the course of professional endeavor, either by act of commission or omission;
• Not reveal any confidential information obtained during a professional engagement without proper authorization, or purposely use such information for personal gain;
• Report facts, observations or render conclusions or opinions for official purposes only after careful consideration of pertinent facts; and
• Continually strive to increase the competence and effectiveness of professional services performed under his or her direction.
CODE OF ETHICS

Institute of Internal Auditors (IIA)

Internal auditors are expected to apply and uphold the following principles:

- **Integrity**
  - The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

- **Objectivity**
  - Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

- **Confidentiality**
  - Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

- **Competency**
  - Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.
**CODE OF ETHICS**

**Auditing Standards Board**

1) proficiency on part of the auditor
2) independence in fact and appearance
3) due professional care
4) adequately planned and properly supervised field work
5) a sufficient understanding of the internal control structure of the audited entity
6) sufficient inspection, observation and inquiries to afford a reasonable basis for an opinion
7) a report stating whether the financial statements are in accord with GAAP
8) identification of circumstances in which the principles have not been consistently observed
9) disclosures (including notes and wordings) in the financial statements are to be regarded as reasonably adequate unless otherwise stated
10) a report shall contain either an opinion of the statement taken as a whole or an assertion to the effect that an opinion cannot be expressed.
## Societies Ethics:
**Kohlberg Model of Cognitive Development**

<table>
<thead>
<tr>
<th>Level</th>
<th>Stage</th>
<th>Disposition</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Post-Conventional</td>
<td>6</td>
<td>Based on universal moral principles</td>
<td>Typical for College Students</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Impartial with concern for everyone’s interest</td>
<td>No more than 25% of society achieves this level</td>
</tr>
<tr>
<td>Conventional</td>
<td>4</td>
<td>Informed by society’s laws</td>
<td>Typical for Adults - Studies have shown majority of auditors are in this range</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>Conforming to group norms</td>
<td>Typical for Teenagers</td>
</tr>
<tr>
<td>Pre-conventional</td>
<td>2</td>
<td>Self-Interest is the primary motivation</td>
<td>Transitionary Stage between toddler and teenager</td>
</tr>
<tr>
<td></td>
<td>1</td>
<td>Avoid Punishment</td>
<td>Typical for young children</td>
</tr>
</tbody>
</table>
WHAT SHOULD YOU DO?

During an audit (for the owner), you find the following:

- The contractor has submitted the same subcontractor changes on multiple owner changes.
- The CM/GC has miscalculated several changes, resulting in a lower GMP.
- The total cost of the miscalculation is far greater than the value of duplicated subcontract changes.
Objective assessment

Should not seek to achieve a specific goal

Should not avoid information which may be unfavorable to the client
Impairment of Ethics
FAC TORS THAT CAN AFFECT THE INDEPENDENCE OF EXTERNAL AUDITORS:

- Lucrative fees
- Desire for repeat business
- Desire to use positive engagements as references
- Long term relationships
- Multiple Service Lines
FACTORS THAT CAN AFFECT THE INDEPENDENCE OF INTERNAL AUDITORS:

- Validating the audit’s worth or function within the organization (I.E. – show results)
- Career planning
- Corporate culture of an organization
- Does not want to be one to “rock the boat”
- Desire to please superiors
“Due to the flexibility and unclear nature of audit standards, auditors can often rationalize finding in favor of their clients”

Bazerman Max H., Morgan Kimberly P., Loewenstein George, “The impossibility of Auditor Independence” Sloan management review (1997),
OTHER INFLUENCES THAT AFFECT AUDITORS

- Ego
- Perception
- Reputation
“...people tend to reach self-serving conclusions whenever ambiguity surrounds a piece of evidence”

Most Accountants Aren’t Crooks—Why Good Audits Go Bad by Max H. Bazerman, George Loewenstein, and Don A. Moore 09 Dec 2002 Harvard Business School Newsletter
WHAT SHOULD YOU DO?

During an audit, you find the following:

- The contractor has provided ongoing meals and entertainment to the owner’s project team under the premise of team building.
- The owner’s team has signed off on these events.
- The findings are immaterial to the size of the project. ...but you know they do not comply with their internal policies.
ITEMS TO CONSIDER DURING AN AUDIT THAT ARE SOURCES OF DISAGREEMENT:
GENERAL

- Audits are typically finite points in time.
- The auditors were most likely not present during the decision-making process on any given item.
- There are many ways that CM/GC’s track costs, billings and commitments.
- Mistakes and Fraud are not synonymous.
- Except for Design Build, CM/GC’s cannot control the quality of the design.
CHANGES

- Scope
- Timing
- Cumulative Impact
SUBCONTRACTORS

► Commitments
► Over and Under Payments
► Changes
► Contracts
CONTINGENCY

- What is Contingency for?
- Design Quality
- Multipliers
OTHER ITEMS

- Insurance
- Retainage
UNAVAILABLE RECORDS

Are costs invalid for the following?

- Unavailable
- Improperly Kept
- Not approved when there is a contractual requirement for approval
WHAT SHOULD YOU DO?

- You find that the owner organization has improperly withheld funds or payments from the contractor.
- The owner has indicated that realized savings on this project will result in future audit work.
- The net result of the finding is in the contractor’s favor.
WHO IS AFFECTED BY BIASED AUDITS

- Constructor (GC, CM, DB, etc)
- Subcontractors/Vendors
- Owner
Be Honest
Be Fair
Be Diligent
Be Reasonable
AUDIT ETHICS

QUESTIONS

PRESENTED BY
JAKE ORTEGO, PE, CCE, CCA, CCP
J@J-A-CEA.COM
(412) 849-2408

JA COST ENGINEERS
& ADVISORS, INC