

(EXPANDED INTERNET LINKED VERSION)

After three years of looking “under the hood” in the Executive Branch (EB) starting with a staff of two investigators/auditors and increasing to five for the past two years, the SIG has a sufficient body of work and experience to discuss fraud, waste, and abuse in the EB. As a reminder of the SIG’s unique mission, it was well described by John Ward, the father of the first state Office of the Inspector General Office in Massachusetts (1981), “**The basic concept behind the IG is that any institution, corporation, university, let alone the institution of government, *must build into itself a mechanism for self-criticism and self-correction*...the IG covers the vast middle ground between the ability to review all state transactions to a limited degree without the power to investigate [i.e., the Auditor], and the power to investigate allegations of fraud on a case-by-case basis [i.e., the Attorney General].**”

Below identifies the EB’s positive attributes and opportunities to improve:

Positive Attributes of the EB

1. EB employees conducting fraud/embezzlement against the state is a low risk with relatively a low loss in dollars. Based on agencies requirements to report frauds to the SIG and the South Carolina Comptroller General coupled with inquiries at the Attorney General’s Office, SLED, the FBI, the SIG determined state employees committed frauds totaling \$414,000 (16 employees) in FY 2013-2014 and \$298,000 (14 employees) in FY 2014-2015. The pattern during these two FYs was one major fraud coupled with 13-15 nominal frauds. For a \$25 billion budget and 60,000 employees, these results are positive towards both state employee integrity and taxpayer accountability. There is anecdotal data suggesting agencies may be allowing employees committing low level fraud to resign and pay restitution without involving law enforcement.
2. The Statewide Procurement System (SPS) fraud risk is low. The SIG conducted a SPS fraud risk assessment, which included interviewing 17 agency procurement officers whose responses mirrored a subsequent anonymous survey to 71 agency procurement officers. To illustrate the results, the anonymous survey asked four “agree/disagree” questions pertaining to the SPS process integrity:
 - The State’s procurement processes are designed to prevent fraud, collusion, or unjust favoritism in the award of public contracts.
 - My agency operates within the State procurement guidelines with fairness.
 - The employees charged with the responsibility to conduct the procurement processes operate with integrity.
 - My agency has adequate controls in place that would reasonably prevent the occurrence of fraud.

The aggregate anonymous results were 99.5% agreed/strongly agreed; 0% disagreed/strongly disagreed; and less than 1% were uncertain.

As a result of historical procurement weaknesses, the State has built a fairly rigorous procurement system many years ago with transparency, feedback loops, controls, audits, and structure to squeeze the risk of abuse down. It works. There appears to be movement to modify the current SPS to speed up procurement timelines, which must be balanced against increasing the risks of fraud and abuse the State has successfully addressed with its existing SPS.

The SIG still has concerns on how agencies use available procurement strategies to generate an increased competitive environment, particularly when re-competing existing contracts. It is not unique to South Carolina, but incumbent vendors seemingly have an inherent edge which can potentially have a chilling effect on competitors' decision to invest money in a competing proposal. Additionally, heightened controls for large dollar RFPs should be considered to insulate and strengthen objectivity of rating panels.

3. The Statewide personnel system to address misconduct appears to be adequate. The Office of Human Resources, Department of Administration, has established mandatory statewide policies in this personnel area that provides sufficient structure and guidance to EB agencies operating in a highly decentralized environment. Governor Haley's model Code of Conduct has substantially increased ethical standards in Cabinet agencies representing just under half of state government employees. However, the residual EB state employees still operate under problematic Codes of Conduct as documented in the Code of Conduct Task Force Report.
4. EB **criminal** corruption risk is low, which may be contrary to a general public perception. Criminal corruption is essentially kickbacks, bribes, or the "old school" bag of cash involving a "quid pro quo" transaction, where an EB employee and subject have a "meeting of the minds" directly correlating the bribe with an abuse of an EB employee's position through an action/decision benefitting the subject. This assessment is based on actual criminal cases by the SLED and the FBI; allegations to the SIG; and three years of interactions within the EB.

Corrupting influence, often called "undue influence," in the EB is an entirely different issue, which, absent unusual circumstances, is essentially **non-criminal** due to a lack of a quid pro quo. The public's skepticism of government questions how much does special interest or self-interest influence move a government employee's judgment to something less than "true north" of making discretionary decisions according to the law, regulations, or sound judgment to benefit the overall public good? This corrupting influence tends to be relationship based where there is no "meeting of the minds" of a "quid pro quo" transaction, but it is understood future reciprocating is not unimportant which is often termed the "good old boy network" or the newer term of "gift economy."

From the SIG's perspective, its hotline is not ringing off the hook with EB corrupt influence allegations, but influence corruption is a subtle concealed act and the lack of complaints does not equate to a non-problem. The SIG has witnessed EB executives having a healthy sense of avoiding inappropriate special interest favors, more than the public would expect. The 24/7 free press news cycle certainly plays a role in this positive public servant behavior, which has served this country well. However, the SIG has also heard of some naked favor requests resisted by EB executives. This raises questions as to why someone would have the audacity to even ask in the first place and how many other unknown naked requests were successful?

Addressing this difficult arena of corrupt influence starts with a clear understanding of the problem -- the days of "bags of cash" for a specific favor are essentially over -- wrongdoing government employees can monetize/benefit from this corrupt influence in a variety of other indirect methods, which, ironically, are also likely quite legal if separated from any connection to a quid pro quo transaction. The citizenry and the State's best defense against corrupting influence is through increased ethical standards, particularly establishing a clear demarcation from where expected political and decision making input ends and undue influence begins. This requires establishing an increased ethical standard requiring formal disclosure or complete avoidance of issues having even the "appearance" of a conflict of interest or causing a reasonable member of the public to perceive a state employee as violating the public's trust.

Absent a clear “appearance standard,” couple with robust financial disclosures, undue influence can easily be rationalized away. This increased ethical standard will change EB employees’ thinking to **avoid** (SIG emphasis) or formally disclose situations causing appearance issues that could violate the public’s trust, rather than publically defend an employee’s reasoning after public reporting when the damage from even a perception, if not worse, causes another withdrawal from the public trust. Perceived violations of the public’s trust can do as much damage as actual violations. Governor Haley’s recent model Code of Conduct adopted by her Cabinet agencies is a good start, but these standards need to be required by all EB agencies.

Given public employees are essentially fiduciaries, there is absolutely no rational basis for any ethical standards lower than the highest possible ethical standards. High standards both deter potential wrongdoers from acting and provide employees a concrete foundation to rebuff an inappropriate/corrupt request.

Opportunities to Improve

1. The state lacks an adequate agency Performance Management System to ensure agencies are operating using fundamental business practices using strategic objectives, tactical strategies, and results aligned with stated objectives, which creates a high risk of waste in state government. While some agencies have seized the benefits of the current system, known as Annual Accountability Reports (AAR), to effectively drive their operations, it has evolved for many other agencies into a superficial annual exercise or more of a self-serving marketing tool. In short, agencies select their own success metrics and decide on their own benchmarks/standards to measure success, all without the state taking the time to systematically analyze this performance system and corresponding data to discern if it is accurate, reliable, and fair. A declining agency can go unnoticed because the state has little capacity to scrutinize and discern, let alone challenge, AAR reports containing inaccurate performance data or hollow management jargon creating the impression of a well-honed operation. A renewed emphasis in a statewide agency Performance Management System represents the single best opportunity to address waste in state government.
2. The State lacks adequate requirements for agencies to conduct contract/grant monitoring, which has resulted in a high risk for waste in state government. The Statewide Procurement System has a rigorous process with adequate management controls in establishing a contract, but then is completely silent on how to monitor the execution of contracts to ensure the State gets its value which is equally true for grants. An investment of subject matter expertise and a standardized risk based framework to contract/grant monitoring will add value through a cost/benefit monitoring strategy based on risk, as well as reduce administrative burden by eliminating typical boilerplate monitoring relying on voluminous reporting more likely to mask problems than identify problems.
3. The state extensively uses the Commission form of oversight for state agencies which suffers from a lack of uniform expectations, which can result in some Commissions not assuming full ownership or possessing executive skills to carry out their fiduciary duty to ensure agency effectiveness. The SIG has seen agencies with well-honed performance metrics briefed/provided to their Commission on a regular basis, with the Commissioners possessing subject matter expertise and executive management experience allowing them to discern agency performance, all of which results in the Commissioners carrying out their fiduciary duty for an effective organization. The SIG has also seen boards who have no idea they have a fiduciary duty to ensure their agency is effective, nor an idea of how to go about achieving an adequate level of due diligence through leading agency staff.

Citizens with subject matter expertise serving as Commissioners to provide oversight to government certainly has obvious and intuitive benefits. However, it also increases the risk of potential conflicts of interest, both real and perceived, when subject matter expert Commissioners also have business interests potentially regulated or impacted by agency decisions. The direction to lower this inherent conflict of interest risk is full adoption by all EB agencies of the Governor's model Code of Conduct, in particular the heightened requirement to avoid perceptions/appearances of conflicts of interest which would require heightened disclosures.

4. State agency internal audit functions should shift focus away from traditional low risk compliance and financial audits and follow the private sector trend towards improving operational performance through improving risk management, control, and governance processes. This concept uses the internal audit skill set to work with management starting at the top of an agency to assess, improve, and ultimately provide independent assurance that agency management has an adequate strategic planning, execution, and measurement system to discern if, and to what extent, an agency is effective. Then, systematically work through the organization with emphasis on leaning out processes based on a risk-based approach and ensuring results are aligned with objectives. The governing body of internal auditors (IIA) standards requires internal audit functions to address the governance issue of providing assurance/assessment of their organization's performance management system, which are AARs in state government; the SIG has not seen it. Agency enterprise-wide risk assessments, a basic internal audit function, are not systematically conducted, which misses the opportunity to create internal and oversight visibility/accountability to address opportunities to improve. South Carolina spends an inordinate amount of accounting and audit energy, time, and money providing assurance to taxpayers every dollar is tracked, but it lacks an adequate capability to provide assurance to taxpayer's of the operational results/outcomes of tax dollars spent.
5. The State has no systemic leadership development program, nor do agencies systemically utilize standard leadership/climate surveys as a tool for feedback to assess opportunities to improve. A recurring theme as the SIG moves throughout state government is the difficulty in addressing poor performance. This tends to be every organization's, private or public, most difficult challenge. In real terms, addressing and confronting problems actually goes against human nature, and absent cultural proactive leadership expectations, it is the minority of leaders who will seek engagement on difficult issues. The tool to start and continually stimulate leadership development and employee engagement is a commitment to an annual or biennial leadership/climate survey. The feedback develops managers and requires agency leadership to engage issues, either indicators of poor leaders or work units, to explore and resolve at an earlier stage than waiting until it becomes visible through a crisis condition.

Potential EB Agency Trends Observed

- Preventative controls to prevent waste in State operated benefit programs have opportunities to improve.
- Regulatory controls have a tendency in both protocols and management inclination to under-address non-compliance in a serious and time-sensitive manner.
- EB agencies are inordinately risk adverse to any form of "bad news." This is normal for any organization, but it seems state agencies just have a higher propensity to strive for no waves, "get along, go along" attitude which just adds to the gravity of the status quo.
- Potential opportunity exists to maximize procurement contracts through both the level of competition and the use of negotiations.

- Outsourcing through contracts or grants, often to non-profits, seems to be viewed as automatically preferential to adding State employees, which is not accurate given the State's high risk in its ability to contract/grant manage. Agencies have a tendency to view their job is essentially complete upon approving a contract/grant, when in fact outsourcing requires heightened skills in contract/grant monitoring and engaged risk based oversight to ensure value received by the State.