



State of South Carolina
Office of the Inspector General

Memorandum

Date: January 6, 2016

To: Honorable Nikki R. Haley, Governor
Honorable Hugh K. Leatherman, Senate Pro Tempore
Honorable James H. "Jay" Lucas, Speaker of the House of Representatives
Honorable Richard Eckstrom, Comptroller General
Honorable Curtis M. Loftis, State Treasurer

From: State Inspector General Patrick J. Maley

Re: The State Inspector General's Observations of the Executive Branch

Enclosed with this memo is a document titled, "The State Inspector General's (SIG) Observations of the Executive Branch (EB) of State Government."

After three years of looking "under the hood" in the 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. The enclosed document sets forth the SIG's observations of the EB's positive attributes and opportunities to improve.

The enclosed document contains State-wide issues that may be relevant to Executive and Legislative oversight for both consideration and context in carrying out their leadership roles over the complex EB of State Government. The enclosed document is a high level summary, which also contains an Internet link to a second more expansive document for those interested in a deeper level of detail. I would gladly provide, if interested, personal briefings using agency specific examples and investigative results to clarify and support the SIG's observations. For your information, SIG waste/effectiveness investigations and lessons learned are contained on its webpage (oig.sc.gov).

Thanks in advance for taking the time to review this data, which hopefully will stimulate discussion and potential ways forward to improve State Government. Again, I welcome the opportunity to meet with anyone or group with an interest in further dialogue about the SIG's observations of the EB.

cc: Chairman W. Brian White, House Ways & Means Committee
Chairman Wm. Weston J. Newton, House Oversight Committee

The SIG's Observations of the **Executive Branch** of State Government

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; a more robust explanation of below items can be found at link: <http://oig.sc.gov/Documents/ExpandedSIGObservations.pdf>.

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.
2. The Statewide Procurement System (SPS) has a low risk of fraud.
3. The Statewide personnel system to address misconduct appears to be adequate.
4. EB corruption requires a bit more explanation in this summary given the public's perception of government corruption, at all levels, and the public debate pertaining to the adequacy of State ethics laws.
 - 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.
 - Corrupting influence, also known as 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. Corrupting influence has 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.” In the EB, corrupting influence does not appear systemic. However, it is exceedingly difficult, if not impossible absent some unique evidence, to disentangle inappropriate “undue corrupt influence” from special interests or self-interest with appropriate influence from constituents, special interests, core beliefs, or other meritorious organizational criteria.
 - 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 emphasizing boundaries and transparency [i.e., disclosure of real/apparent conflicts; no gifts; robust financial disclosures; and duty to report].

- Most important is establishing a clear demarcation where expected political and decision making input ends and the increased risk of undue influence begins. This requires 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. In today’s era of the public’s diminishing trust in government, a rigorous “appearance” standard is required to improve public confidence in government. It protects from both perceived violations of the public’s trust which can do as much damage as actual violations, as well as shrinks the operating space where the risk of undue influence is heightened. 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.

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. 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.
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. Citizens with subject matter expertise serving as Commissioners to provide oversight to government certainly has obvious and intuitive benefits, but 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.
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. 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.
5. The State has no systemic leadership development program, nor do agencies utilize standard leadership/climate surveys as a tool for feedback to assess opportunities to improve.

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 a 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.