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Ethical Challenges in State and Local Government:

Creating an Environment of Ethical Awareness to Prevent Fraud



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Learning Objectives

At the end of the session, you will be able to:

- Identify and differentiate the principles and key concepts of personal ethics and business ethics
- Recognize the need for ethics in business to help mitigate risks to the organization
- Describe case examples of ethical violations that lead to fraud
- Identify and describe the attributes of a highly ethical organization



Speaker Introduction

Principal

CLA's Forensics Practice

20 years of experience leading fraud investigations, forensic accounting projects, and internal control reviews for government organizations, nonprofits, and commercial businesses.



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CPA/CFF, CFE,
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Ethics Concepts



Personal Ethics - Values

What are your personal values?

- Simply: The things that are important to you in life

It should be easy to live by your “values,” right?

NOT ALWAYS! Why?

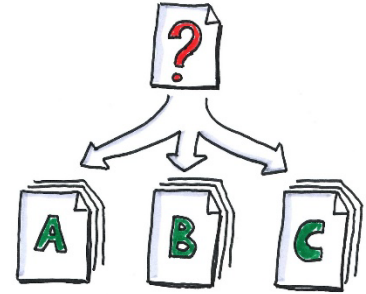


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Personal Ethics - Values

Personal ethics can change over time – depending on what is most important to you. Or can change from situation to situation, based on how you perceive your “role” in each situation.



Role Morality - Feeling you have permission to make ethical decisions that may harm others in ways that would be wrong if it weren't for the role you're playing. But because you're acting on behalf of someone else's best interests, you view your actions as permissible.

Personal Ethics - Values

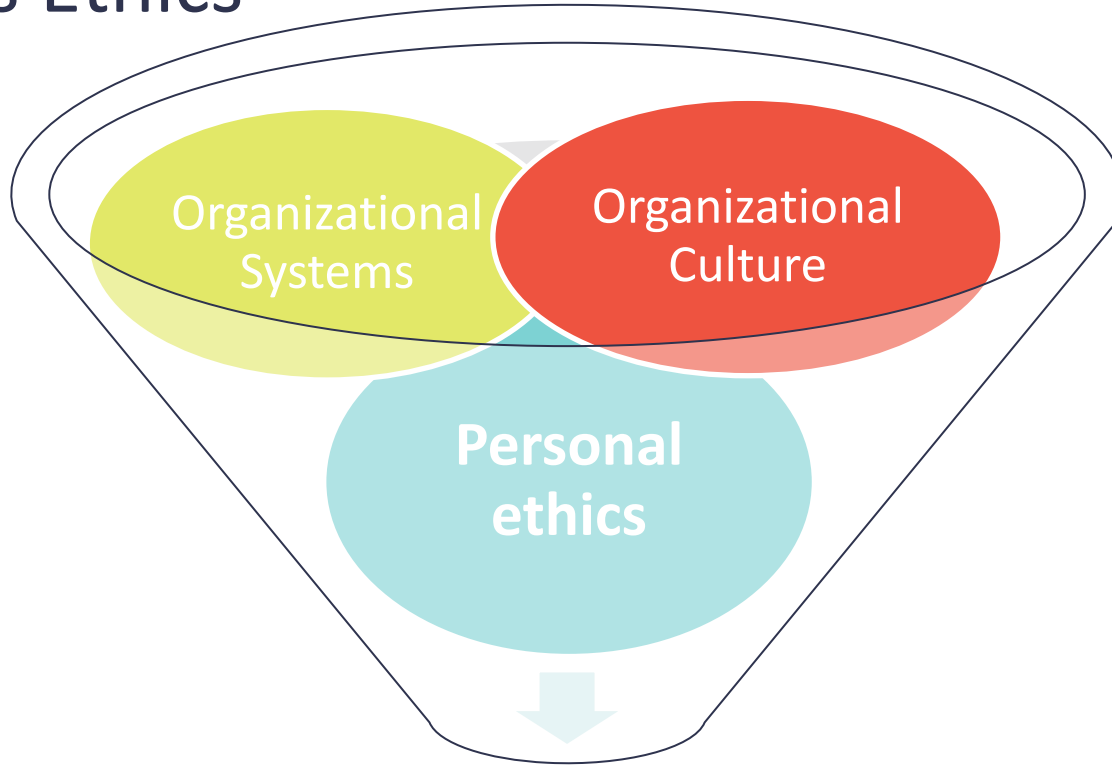
- Ethics means different things to different people.
- What has helped you define your personal ethics?
 - Faith?
 - Spirituality?
 - Upbringing?
 - Family?
 - Moral code of conduct?
 - Laws and civil rights?
 - Academia?



HOW ARE MY PERSONAL ETHICS RELEVANT TO MY JOB?



Business Ethics



Are the decisions made by an organization ethical?



Polling Question: Let's Hear from You...

In your opinion, which of these has the most impact on whether a company is ethical?

- A. Organizational systems
- B. Organizational culture
- C. Personal ethics of employees



Principles of Ethics in Business

Honesty

Integrity

Loyalty

Fairness

Concern/Respect for others

Courage



Practicing Ethics – Inside & outside the workplace

Honesty

- Returning extra change/driving the speed limit
- Not withholding information from employees

Integrity

- Keeping promises to your kids over work commitments
- Don't accept praise for or steal others' ideas/work

Loyalty

- Sticking up for a friend who is the subject of gossip
- Recognize others for their accomplishments



Practicing Ethics – Inside & outside the workplace

Fairness

- Don't take sides in family disputes
- Hold all team members accountable

Respect

- Practice active listening
- Welcome and encourage diversity

Courage

- Speak up when you see someone being mistreated
- Speak up when you see unethical or inappropriate behavior



Polling Question: Why is Ethics Important in Business?

- A. It helps employees make good decisions and in turn leads to happier, more satisfied employees.
- B. It reduces liability.
- C. It ensures high-quality customer service.
- D. All of the above.



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And most importantly, it keeps everyone off the front pages!



Moral Muteness

Moral Muteness is:

1. Not speaking up when witnessing unethical behavior
2. The unwillingness to discuss ethics
3. Discussing practices/decisions in a way that obscures your moral position and ethical beliefs
(Bird & Walters, 1989)

What causes moral muteness?

Discussions of ethics can be threatening to harmony, efficiency, or power.



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Ethical Fading



An erosion of the **ethical** standards of a business in which employees become used to engaging in or condoning bad behavior.

Ethical Fading

The inability to see that a situation requires an ethical judgement

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Ethical Challenges in Government



Ethical Challenges Turned Fraud....

Charging non-grant costs to federal/state contracts

Abuses of credit cards
– meals; travel; etc.

Staff benefiting personally from organization assets

Awarding grant funds to family or friends

Awarding vendor contract to family or friend

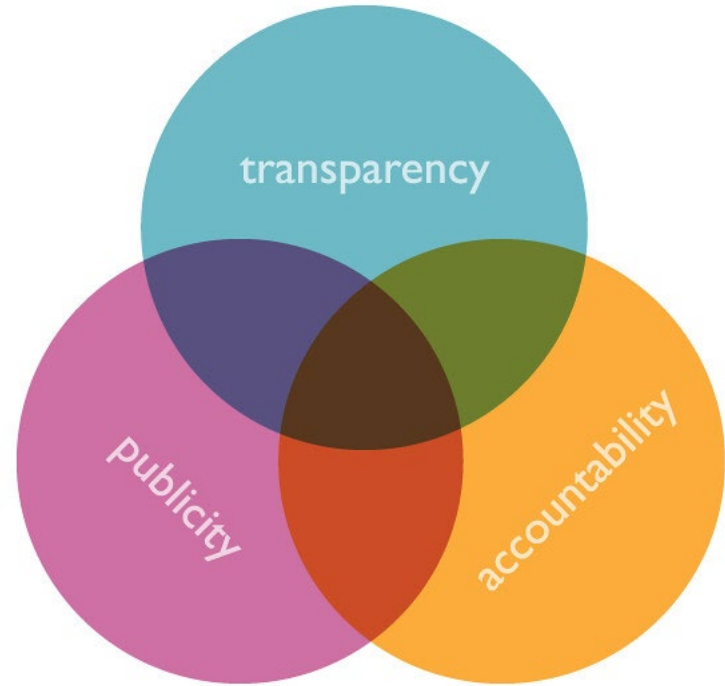
Allowing employees to pad their timesheets to compensate for “value”



Ethical Challenges in Government

The importance of:

- Perception – What is more important, reality or perception?
- How is transparency achieved?



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Ethics and the Law

- Do unethical decisions always involve illegal behavior? **NO!**





Case Study #1



Case Study #1 – World Trade Center Rebuilding

- 16-acre site
- \$20 billion reconstruction project
- 4 office buildings, Oculus transportation hub, Memorial Plaza and Museum, underground infrastructure, streets, utilities, open spaces
- Port Authority of New York & New Jersey provided oversight
- Integrity monitors assigned to each major project



Case Study #1 – World Trade Center Rebuilding

Surveillance/
Intelligence gathering

Audit/Forensic
Accounting

Integrity
Monitor

Engineering

Legal



Case Study #1 – World Trade Center Rebuilding

Ethical challenges on a construction project

- Organized crime
- Material substitution
- Material theft
- Ghost employees
- Overcharging



Case Study #1 – World Trade Center Rebuilding

- PANYNJ contracts contained MWBE goal
- DCM was steel contractor on at least 3 projects at WTC
 - Canadian company with nearly \$1 billion in contracts
- Subcontracted with Solera/DCM (minority-owned business) for metal decking installation and steel procurement
 - Workers sourced through different, non-MWBE contractor
 - DCM handled steel procurement



Case Study #1 – World Trade Center Rebuilding

- DCM also subcontracted with GLS (woman-owned business) for payroll processing and surveying services
 - GLS's owner had been a full-time DCM employee until early in the WTC project
 - Performed the same services as a subcontractor as she had as an employee
 - Surveying services were performed by DCM employees



Case Study #1 – World Trade Center Rebuilding

Polling Question: What do you think about this ethical lapse?

- A. Fraud/Illegal
- B. Not fraud/illegal
- C. Don't know



Case Study #1 – World Trade Center Rebuilding

- What happened?

DCM's owner convicted of one count of wire fraud and one count of conspiracy to commit wire fraud.

Conviction was voided one year later.

PANYNJ's MWBE goal was "aspirational".

There was no actual or potential economic harm.



Case Study #1 – World Trade Center Rebuilding

Conclusions

No economic loss on construction projects.

Violation of Honesty and Integrity principles of business ethics.

Time and money spent on prosecution.





Case Study #2



Case #2 – State Department of Transportation

- DOT review of activities and expenditures raised expense account questions regarding a certain department
 - Allegations of discrimination, intimidation, harassment
 - Process of hiring consultants
 - Sponsorships
 - Transfer of funds to an outside non-profit
 - Training, expense accounts, travel and mileage expenses



Case #2 – State Department of Transportation

- Phase One: Get familiar with the organization and allegations
 - Read statutes and regulations, policy manual
 - Review accounting system, federal grant SOWs and reports
 - Professional service agreements executed by department
 - Vendor backgrounds
 - Employee backgrounds
 - Interviews with personnel



Case #2 – State Department of Transportation

- Phase Two: Analyze the data
 - Employee time and badge entry records, Outlook calendars
 - Computer and cell phone forensics
 - Employee expense reports
 - Purchasing and credit card expenditures
 - Grant records



Case #2 – State Department of Transportation

Findings: Procurement violations

- 19 contracts that did not follow competitive bid process
 - Avoided the normal procurement processes
 - Lacked appropriate approval and oversight
- 7 noncompetitive contracts for work traditionally performed in-house
 - No justification for outsourcing the work
 - Corrosive to morale of the department
 - Department staff continued to do most of the work
- Noncompetitive contracts issued to vendors with personal relationships with department director



Case #2 – Gov't Construction Bond Program

Findings: Procurement violations

- Contract amounts increased without justification
- State funds used to underwrite events outside of department mission
 - \$97,000 spent on awards, banquets, galas, scholarships, advertisements unrelated to department mission
 - Department policies not followed, lack of appropriate oversight
- Unauthorized use of purchasing cards
 - Department director coerced subordinate to make copy of their P-Card for Director's use



Case #2 – Gov't Construction Bond Program

Findings: Employee behavior

- Department employees conducting personal business using state technology on state time
 - Personal documents and images found on computers
 - Other employees saw it but didn't report it because they thought it wouldn't be addressed
- Violation of secondary employment standard operating procedures
 - Department director and a manager had secondary employment and had not completed the required notifications/request for authorization
 - Attempted to recruit other employees to participate



Case #2 – Gov't Construction Bond Program

Findings: Federal grant administration

- Federal grant funding not expended timely
 - Department rarely expended awards in designated fiscal year, approximately \$1.6 million from prior period funding was unspent
 - Management limited access to information and excluded others from decision making process
- Federal grant reports not filed timely
 - Certain required quarterly and annual reports were missing
 - Puts future funding at risk



Case #2 – Gov't Construction Bond Program

Findings: Hostile work environment and low morale

- Possible atmosphere of sexual harassment, chauvinism, dictatorial management, condescension and retaliation for nonconforming behavior.
- Sense of hopelessness that things would change
- Low productivity
- Lack of accountability



Case #2 – Outcome

- Director resigned
 - No evidence of use of funds for personal financial benefit
 - Circumvented department rules
 - Director’s behavior had widespread impact on others in department
- Director’s boss was transferred





Attributes of a Highly Ethical Organization



Attributes of a Highly Ethical Organization

1. Person or office dedicated to anti-fraud, ethics, and compliance
2. Lead by example (“tone at the top”)
 - a. Highest level management promote an environment of high ethics and integrity
 - b. Governance holds top level executive accountable
3. Encourage transparency and accountability
 - a. Review, oversight, monitoring
4. Well developed anti-fraud and ethics policy
 - a. Documented in writing and communicated to employees
 - b. Read and acknowledged by all employees
 - c. Communicate during hiring; carefully screen job applicants
5. Well developed and updated written policies and procedures



Attributes of a Highly Ethical Organization

6. Regular technical training of employees on policies, procedures, applicable laws, ethics, fraud awareness, etc.
7. Strong compliance/internal audit programs
 - a. Internal, outsourced, or combination
 - b. Prioritized and communicated
 - c. Access to Governance
8. Establish a fraud and ethics hotline
 - a. Provide for anonymity
 - b. Maintain confidentiality
 - c. Incorporate whistleblower protections; protect employees that come forward
9. Reinforce good behavior; don't reinforce bad behavior
 - a. Follow through with reports of misconduct and promote effective internal controls
 - b. Encourages people to come forward





Questions



Thank you!

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