Ethical Challenges in Business Decisions

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Learning Objectives

Recognize the need for ethics to help mitigate risks to organizations

Describe case examples of ethical violations that lead to fraud

Identify and describe the attributes of a highly ethical organization

Speaker Introduction

Manager

CLA's Forensics Practice

Over 11 years of audit, tax, and consulting experience serving state and local governments, nonprofits, and for-profit entities including forensic accounting engagements, fraud investigations, and internal control assessments.

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Ethics in Business

Ethical Leaders Start at Home

Personal Ethics

- Values
- Moral choices
- What we do when no one is looking
- Can change over time or by situation or role
- Defined by:
  - Faith, spirituality
  - Upbringing, family
  - Laws, civil rights, academia

Business Ethics

- Personal Ethics
  - Values of the employees
- Organizational Culture
  - Tone at the top
  - History of the company
  - Perception of what is acceptable
- Organizational Systems
  - Policies and rules in place
  - Regulatory oversight
  - Code of ethics and how it's monitored and enforced

Principles of Ethics in Business

Honesty

- Reliably share information with employees
- Tell the truth in communication and action

Integrity

- Be consistent between words and actions
- Honor your commitments

Loyalty

- Respect confidential information
- Recognize others for their accomplishments

Fairness

- Hold all employees accountable
- Treat others the way you want to be treated

Respect

- Practice active listening
- Welcome and encourage diverse viewpoints

Courage

- Speak up when you see mistreatment
- Speak up when you see unethical behavior

Why is Ethics Important in Business?

- Helps employees make good decisions; leads to happier, more satisfied employees
- Reduces liability
- Ensures high quality customer service
- Most importantly, keeps everyone off the front pages!

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Breakdowns in Business Ethics

Moral Muteness

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

Ethical Fading

- Erosion of the ethical standard of a business in which employees become used to engaging in or condoning bad behavior

Situational Influence

- Intent to please authority figure
- Focused on achieving a goal

Examples Leading to Fraud

Declines in revenues/funding	Charging non-grant costs to federal/state contracts
Employee had an accidental mischarge on a credit card that was not caught	Abuses of credit cards – meals, travel, etc.
Trying to get the work done under a time crunch	Not following procurement laws to award contract
Manager concerned about employee quitting due to compensation concerns	Allowing employees to pad their timesheets to compensate for “value”

Case Example #1

County Recycling Center

Overview – County Recycling Center

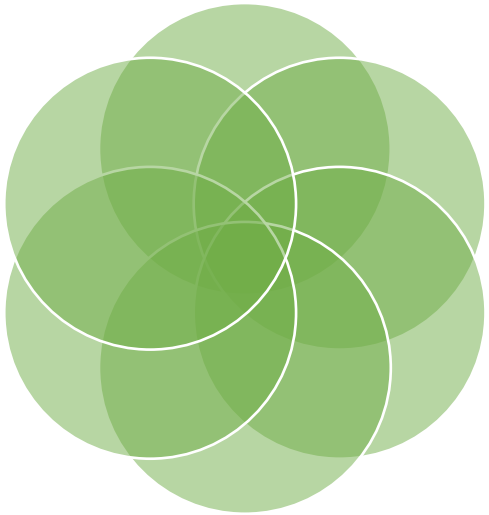
- Joint venture between two neighboring Counties
- Oversight by both Counties, but Recycling Center also has its own employees
- One County operates as the fiscal agent for the Recycling Center
- Long-time employee, Supply Chain Coordinator, misappropriated over $100,000 in 5 years (January 2018-November 2022).

Factors Leading to Fraud

30+ year history

Limited review by others

Known as the “mom of the plant”



Systems not linked

Lots of trust and respect

Sole responsibility for cash deposits

Discovery of Discrepancies

Discovered when “something just didn’t seem right” with one deposit made

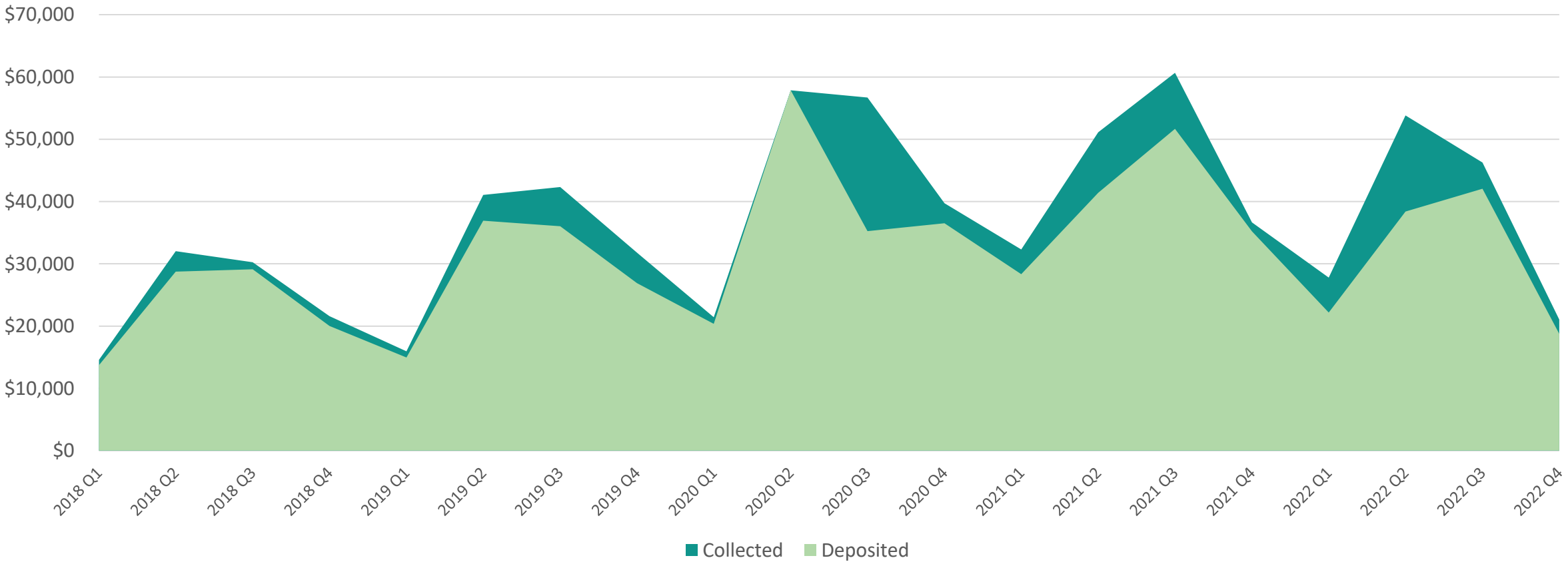
Upon closer inspection, found two days’ worth of collections missing from the deposit

Prompted investigation of historical deposits

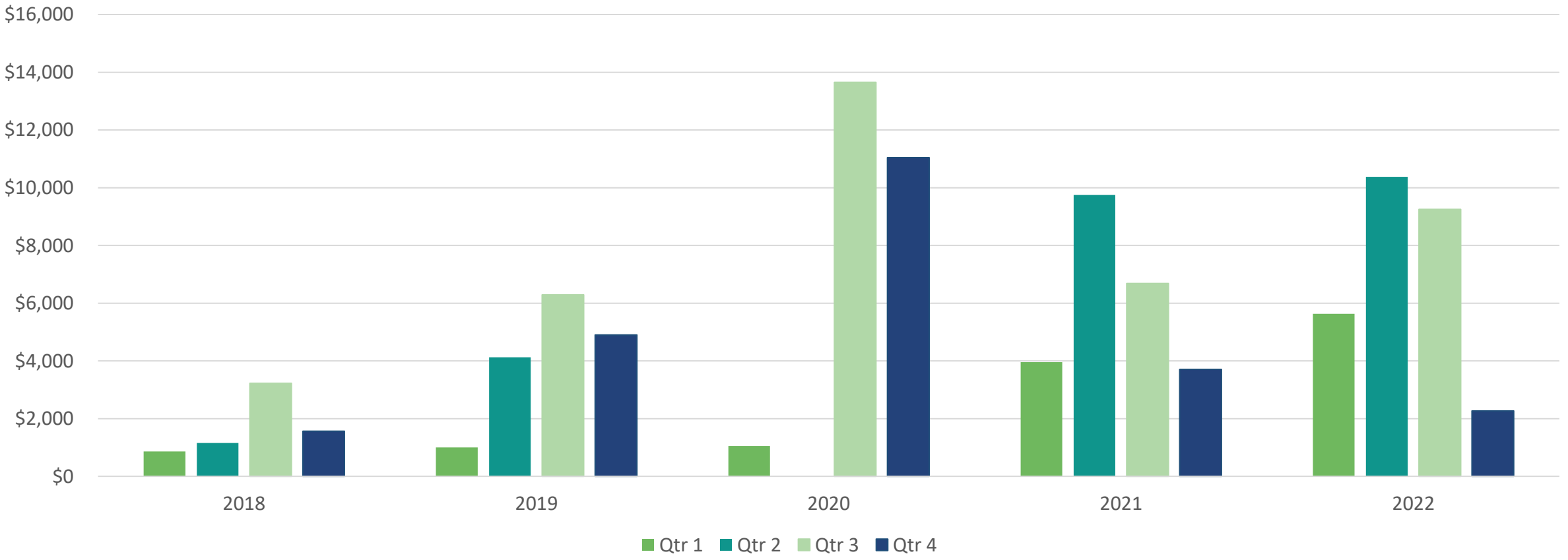
Forensic Investigation

- Interview of staff at the Recycling Center
- Analysis on cash collection reports and cash deposit records
- Identification of days of collections never deposited
- Interview of subject
- Report of findings, including recommendations

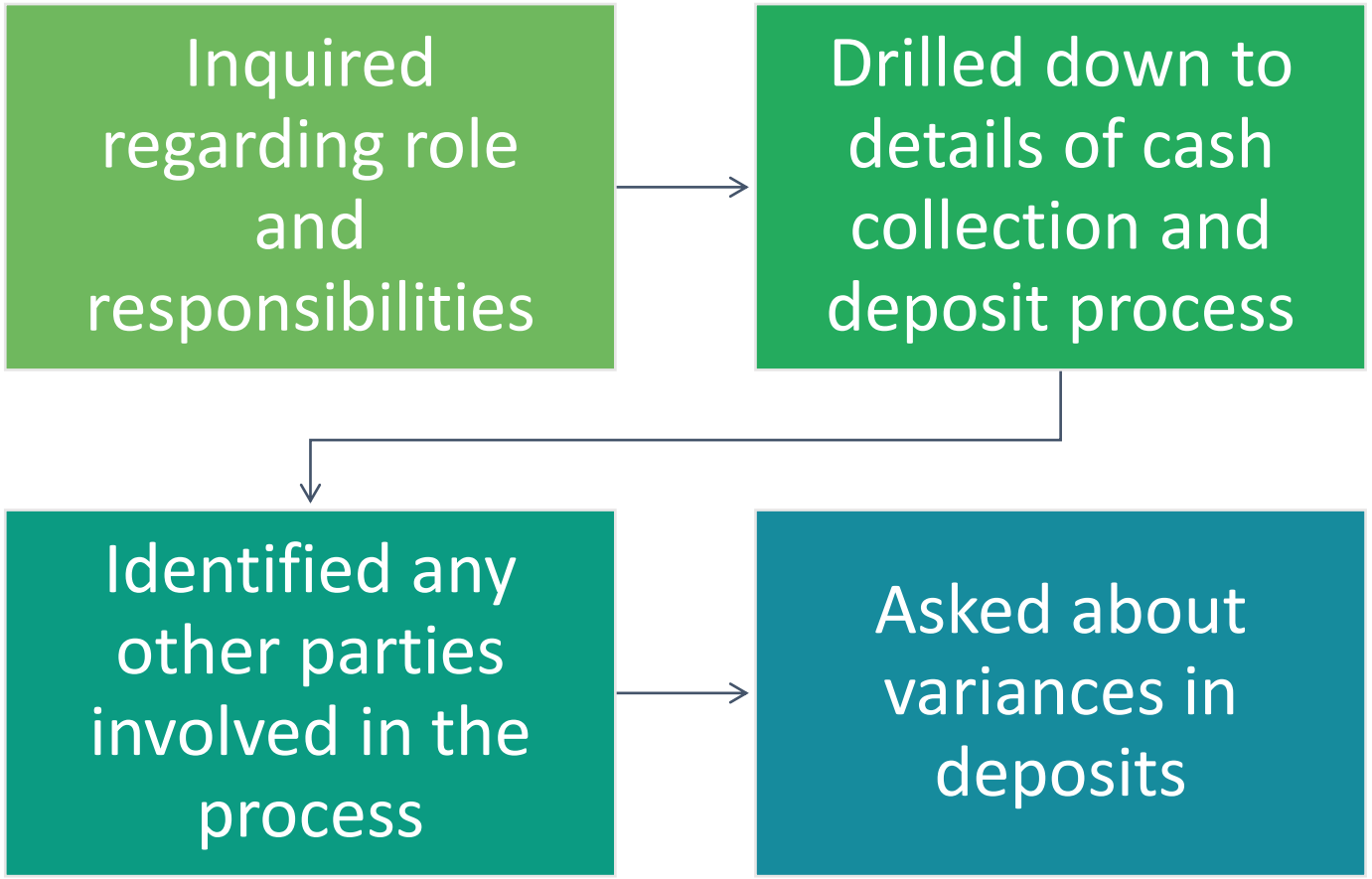
Analysis on Cash



Cash Variances



Interview of Subject



Conclusions

Identified over $100,000 in misappropriated cash deposits

- Cash collected but not deposited
- No other subjects – access and knowledge
- Scope limited to 2018-2022

New procedures were implemented

- Third-party courier for cash transport
- Additional reconciliation of cash collections and deposits are performed

Ethical Breakdown

Position of Trust and Authority

- No review or oversight of cash process
- Lack of scrutiny over Supply Chain Coordinator's responsibilities

Lack of Review by Accounting Manager

- No desire to perform additional tasks
- Lack of understanding of risks and weaknesses in process

Lack of Complete Reconciliation Process

- Lack of understanding by accounting staff
- Confusing financial information obscured lack of reconciliation process

Case Example #2

State Agency

Overview – State Agency

- State Agency that receives federal grant funds
- Corruption/embezzlement of federal funding
- Agency has $1 billion in economic contributions per year
  - CLA's scope was $226 million in applicable federal disbursements
- Executive Director was in role approximately 4 years
  - Started career with the state and appointed as ED
  - No known financial or other issues but appeared to desire recognition
  - Desired to establish a holistic family approach to assistance

Forensic Investigation

- Interviews of current and former Agency staff and grant recipients
- Identification of relevant documentation, including grant documents
- Review and analysis of grant documentation
- Analysis of subgrantee activity
- Report of findings, including recommendations

Schemes

Bypassing procurement procedures, ED selected two subgrantees to execute the state agency's initiatives and increased their funding from less than $1 million to $14-19 million per year

ED used their influence with the subgrantees to have contracts awarded to family and friends for vague scopes of work or for work they were not qualified to perform

ED used their influence to have the subgrantees pay for personal expenses of family/friends

ED used their authority to coerce monitoring staff to not perform appropriate monitoring of subgrantees

Analysis on Grant Awards

- ED awarded subgrants to 3 favored subgrantees
  - Program had 28 total subgrantees
  - 3 were favored by ED
  - Scope of work for subgrantees was generic and high level
  - Subgrantees were not required to provide supporting documentation with their monthly reporting
  - No accountability for how funding was used
- Allegation by subgrantee: ED used threats of withholding funding to coerce subgrantee to award contracts

Transactions with Family

- ED employed their brother-in-law and nephew and also engaged them as independent contractors
  - Excessive compensation for their experience and responsibilities
  - No evidence of work being performed
  - Overlapping periods as employees and as independent contractors
  - Full contract amount was paid at the time the contracts were executed

Transactions with Friends

- ED employed friends and also engaged them as independent contractors
  - One specific friendship with the family of a public figure; ED viewed relationship as beneficial and a way to open doors
  - Many times, individuals established an LLC within a week of discussion with the ED
  - Lump sum payments made on established contracts and many times on the same day the contract was signed
  - Little to no evidence of work being performed
  - Payments for rehabilitation services to a family member, and while receiving treatments, also received payroll and travel reimbursement payments

Conclusions

CLA found approximately:	The Executive Director resigned from their position	The Executive Director was indicted, and the criminal litigation is pending
• $1m – conflicts of interest • $7.5m – undue influence and favoritism • $3.8m – waste and abuse		

Ethical Breakdown

Bypassing Controls

- ED circumvented controls for procurement to select specific subgrantees
- No formal oversight of ED's actions on awarding funds

Influence Over Subgrantees

- ED used position of power over subgrantees and threats to direct funds to family and friends
- No oversight over ED's actions

Payment of Personal Expenses with Grant Funds

- ED influenced subgrantees to pay personal expenses of friends and family
- No review in place for proper use of grant funds

Coercion of Monitoring Staff

- Used position of power to coerce monitoring staff, thereby overriding controls in place
- No oversight over ED's actions and approvals

Attributes of Highly Ethical Organizations

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- ❑ Person or office responsible for anti-fraud, ethics, and compliance
  - ✓ Empowered by management and governance
- ❑ Lead by example (“tone at the top”)
  - ✓ Management and governance promote an environment of integrity
- ❑ Encourage transparency and accountability
  - ✓ Review, oversight, monitoring
- ❑ Well-developed anti-fraud and ethics policy and/or code of conduct
  - ✓ In writing, communicated to and acknowledged by employees
- ❑ Well-developed and updated written policies and procedures
  - ✓ Kept current and acknowledged by employees

Attributes of Highly Ethical Organizations

- ❑ Regular technical training of employees on policies, procedures, applicable laws, ethics, fraud awareness, etc.
  - ✓ Internal or external instructors
- ❑ Strong compliance/internal audit programs
  - ✓ Internal, outsourced, or combination – prioritized by management and governance
- ❑ Established fraud and ethics hotline
  - ✓ Anonymous, confidential, protect whistleblowers – prioritized by governance
- ❑ Reinforce good behavior and don't reinforce bad behavior
  - ✓ Follow through on reports of misconduct – encourages people to come forward

Questions?

Thank you!

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Appendix 1

Code of Conduct – Recommended Components

Code of Conduct

- Definitions of what is considered unacceptable
- Consequences of any breaches
- Example topics:
  - Conflicts of interest
  - Outside activities, employment, directorships
  - Relationships with clients/customers, suppliers/vendors, and other 3rd parties
  - Gifts, entertainment, favors
  - Kickbacks and secret commissions
  - Handling of organization records, communications, funds, and other assets

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