Winnipeg

Fraud and Waste Hotline Research Study

September 2010

Leaders in building public trust in civic government

Audit Department

TABLE OF CONTENTS

Table of Contents 2
Mandate of the City Auditor 3
Background 3
Objectives 3
Scope and Approach 3
Fraud Trends in North America 5
City of Winnipeg Fraud Reporting 6
What is a Fraud and Waste Hotline 7
Implementation of Fraud and Waste Hotline is becoming common practice 8
Fraud and Waste Hotlines in Canadian Cities 8
Number of Calls Received 9
Losses and Outcomes of Reports 10
Operation of Fraud and Waste Hotlines 11
Costs to Operate 12
Implementation and Communication 12
Conclusion and Recommendations 13

MANDATE OF THE CITY AUDITOR

The City Auditor is a statutory officer appointed by City Council under the *City of Winnipeg Charter.* The City Auditor reports to Council through the Audit Committee (Executive Policy Committee) and is independent of the City's Public Service. The City Auditor conducts examinations of the operations of the City and its affiliated bodies to assist Council in its governance role of ensuring the Public Service's accountability for the quality of stewardship over public funds and for the achievement of value for money City operations. Once an audit report has been communicated to Council, it becomes a public document.

BACKGROUND

A research study on fraud and waste hotlines was identified in the City Auditor's Audit Plan for 2009 to 2010. In July 2006, the City of Winnipeg Fraud, Theft or Related Irregularities Administrative Standard was approved by the Chief Administrative Officer (CAO) with the City Auditor agreeing to conduct investigations referred by the Public Service under this Administrative Standard. Since the implementation of the standard there have been three anonymous tips reported to the Public Service and no matters have been referred by the Director of Corporate Support Services to the City Auditor for investigation.

To enhance existing fraud controls, many municipalities across Canada have implemented a fraud and waste hotline in conjunction with their fraud prevention and detection programs and policies. With the recent increases in reports of fraud in other large organizations, fraud policies and whistle-blower protection have become effective methods of ensuring the protection of assets and have been adopted by many Canadian cities. Whistle-blower protection enables employees to report on suspected or known cases of fraud or waste anonymously without being subjected to dismissal, discipline, suspension, penalty or related threats.

OBJECTIVES

The objectives of this report were to:

- Conduct research on fraud and waste hotlines to determine whether additional measures would help enhance the existing methods of reporting fraud, waste or related irregularities in the City;
- Analyze the costs and benefits associated with the implementation of an anonymous fraud and waste hotline and identify the best practices;
- Review the practices in other cities concerning the use of anonymous fraud and waste hotlines and to identify the trends in fraud that are reported.

SCOPE AND APPROACH

This research study focused on hotlines for employees to report any concerns or incidents of fraud or waste anonymously in both the public and private sector.

The following activities were conducted by audit staff to complete this research study:

- Researched and reviewed the leading practices used by organizations for reporting fraud and waste;
- Researched and reviewed information from other Canadian municipalities that had implemented an anonymous employee hotline for reporting fraud or waste;
- Researched and reviewed reports on the operations of anonymous fraud and waste hotlines in North America;
- Reviewed the existing City of Winnipeg Fraud, Theft or Related Irregularities Administrative Directive and related procedures;

- Contacted a third-party hotline service provider to obtain information regarding the implementation and cost of an anonymous hotline; and
- Conducted general research on fraud hotlines.

Members of the Review Team
Bryan Mansky, MBA, CMA, CIA Deputy City Auditor Larissa Klimchak, CMA Auditor



September 1, 2010

Brian Whiteside CA·CIA
City Auditor

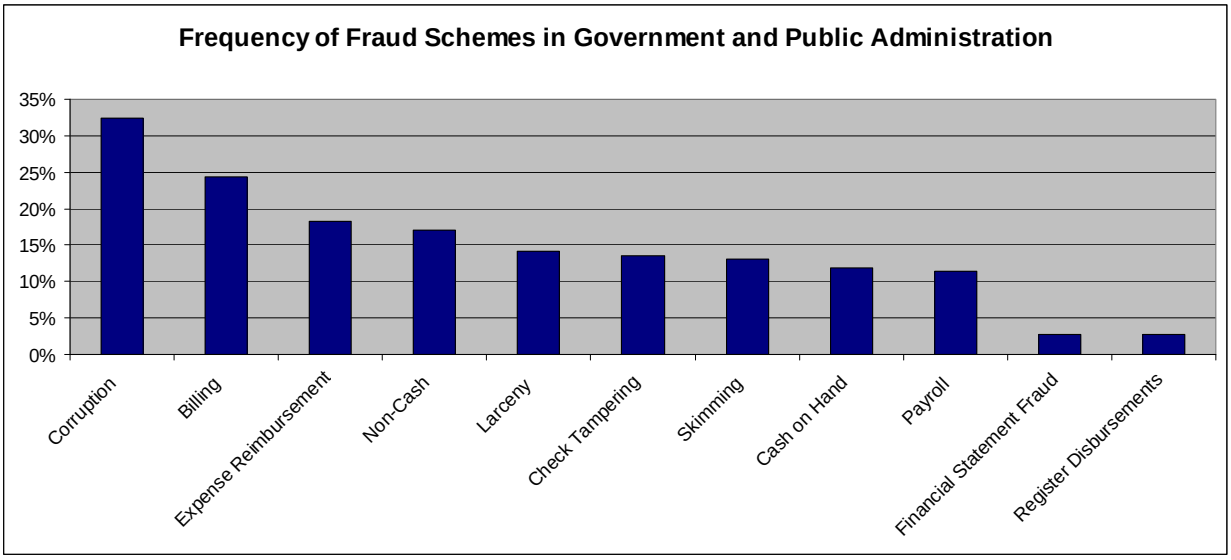
Date

FRAUD TRENDS IN NORTH AMERICA

Fraud is any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain[1]. The Association of Certified Fraud Examiners use the term "occupational fraud" to describe fraud in which an employee abuses his or her position within the organization for personal gain. Occupational fraud is defined by the association as: *the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organizations resources or assets.*

The Association of Certified Fraud Examiners in its *Report to the Nations on Occupational Fraud and Abuse* found that the typical Canadian organization loses 5% of its annual revenues to fraud every year. The median length of time to discover a fraud was determined to be 18 months and the number one scheme of fraud amongst government and public administration is corruption.

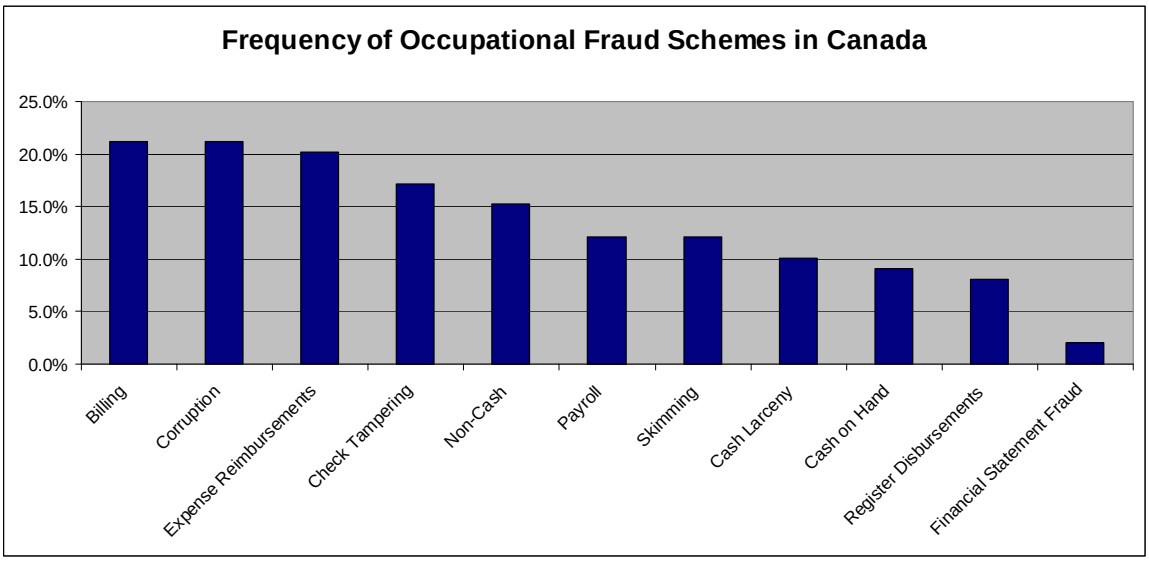
The following chart illustrates the distribution of fraud schemes amongst government and public administration by scheme type.



Source: Report to the Nations on Occupational Fraud and Abuse, 2010 Global Fraud Study

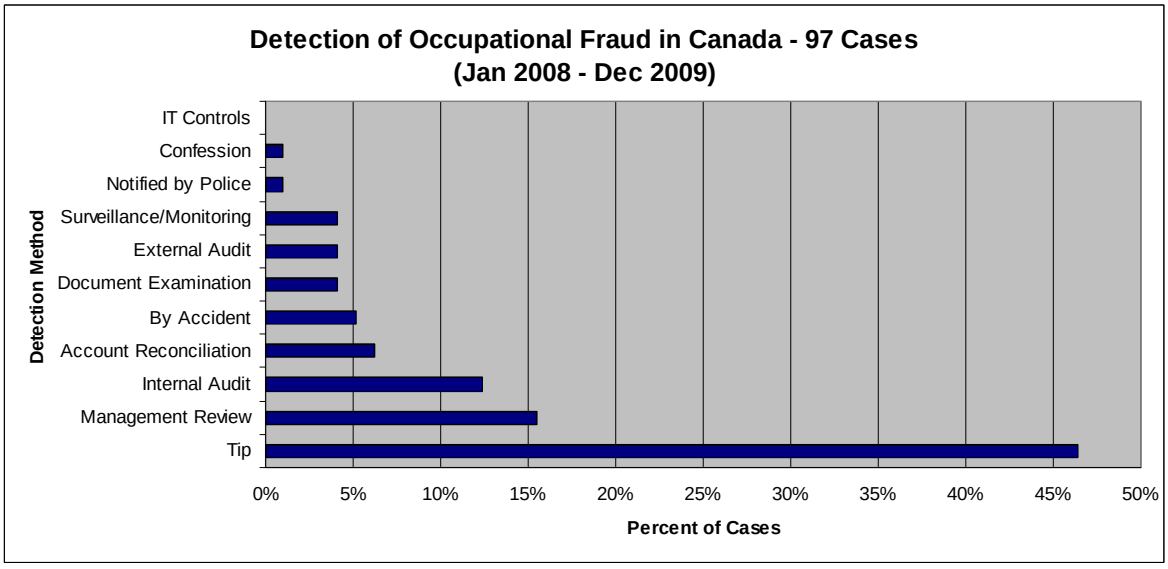
[1] *Managing the Business Risk of Fraud: A Practical Guide* – Sponsored by: The Institute of Internal Auditors, The American Institute of Certified Public Accountants and the Association of Certified Fraud Examiners

Furthermore, as part of the Certified Fraud Examiners Association's 2010 global survey, the frequency of fraud schemes in Canada across all industries was surveyed and the results are illustrated in the table below.



Source: Report to the Nations on Occupational Fraud and Abuse, 2010 Global Fraud Study

Tips received through a hotline are the number one method of detecting fraud according to the Association of Certified Fraud Examiner's 2010 *Report to the Nations on Occupational Fraud and Abuse.* Fraud being discovered by a tip through a hotline accounted for 47 percent of the frauds detected. This study also determined that 39 percent of people are more likely to report fraud if they could remain anonymous and losses are reduced when a hotline is present.



Source: Report to the Nations on Occupational Fraud and Abuse, 2010 Global Fraud Study

CITY OF WINNIPEG FRAUD REPORTING

In July 2006, the City of Winnipeg Fraud, Theft or Related Irregularities Administrative Standard was approved by the CAO. This Standard states that any incidents of fraud or violation of the code of conduct of which an employee is aware of are required to be reported by the employee to their manager or supervisor. Since its

implementation, two incidents were reported in 2007, one incident was reported in 2008 and none were reported in 2009. Two of the reports were made anonymously through a letter and a phone call. The third report was made through an email where the author of the email wished to remain anonymous. One of the reports resulted in an investigation conducted by the external auditor. None of the reports were in compliance with the Administrative Standard as none of the reports were made to a supervisor or manager as is directed in the standard. The reports were received by the City Auditor, a City Councilor and the Winnipeg Police Service Winnipeg Commercial Crimes Unit.

With the implementation of a fraud and waste hotline, where callers can remain anonymous, research indicates that the number of reports made would increase as people are more likely to report information to a hotline where they are assured anonymity. Some employees hesitate to report information regarding fraud or waste as they do not want to reveal their identity due to fears about potential retaliation for reporting a peer or manager.

WHAT IS A FRAUD AND WASTE HOTLINE

A fraud and waste hotline is a valuable tool used by organizations to identify potential unethical behaviour, fraud or waste through anonymous reports from employees. These hotlines can be a valuable deterrent and preventative tool to mitigate the risks related to fraud and waste within the organization as they provide employees an anonymous means to report actual or perceived wrongdoing in the work place. The hotlines are operated with complete anonymity and provide an opportunity for employees to report their concerns.

The type of reports that could be received through the line includes:

- Misuse of City funds or resources
- Duplication of efforts, work being performed on non-essential activities and work not being performed at all
- Unethical behaviour regarding improper conduct or alleged violations of the Code of Conduct
- Breaches of confidentiality
- Violations of any of the human resource policies and administrative standards (e.g. Respectful Workplace, City of Winnipeg Fraud, Theft or Related Irregularities)
- Allegations of fraud (e.g. misappropriation of funds)

A Fraud and Waste Hotline is a service which employees can use to report information regarding fraud, waste and breaches of the code of conduct anonymously. In some cases employees prefer an anonymous telephone hotline because they have more confidence that there will be no reprisal as a result of their statement. Furthermore, depending on the significance of the issue and the type of incident being reported, remaining anonymous may be an important condition for making a report. If the incident involves management or co-workers and if the incident, if discovered, has a significant impact to the organization and could result in the termination of an employee, the potential whistler-blower can be hesitant and reluctant to report another employee due to fear of retaliation and of being ostracized by co-workers. There is also the fear that reporting an incident could affect the employment of the whistle-blower themselves. It is the fear of the repercussions that may impede employees from reporting incidents. Employees must be confident in knowing that they can report an incident effectively, confidentially and anonymously.

The potential advantages of a hotline include:

- Provides a centralized reporting or communication mechanism for employees to report concerns;
- Identifies areas where internal controls need to be modified or enhanced;
- Encourages reporting of internal and external frauds without the fear of reprisal;
- Demonstrates the city's efforts to improve the accountability and transparency of its operations;
- Deters fraud by increasing the perception of being detected;

- Increases employee comfort levels and willingness to report misconduct;
- Offers the opportunity for the employee to report incidents anonymously ; and
- Facilitates the reporting of alleged misconduct in a confidential manner.

Implementation of Fraud and Waste Hotline is becoming common practice

In the private sector, companies have been increasing the use of fraud and waste hotlines due to the significant accounting and management scandals that have occurred within large organizations. With the implementation of the Sarbanes-Oxley Act in 2002 in the United States, the Audit Committee of the Board of Directors of publicly traded corporations are required to provide a mechanism for reporting financial irregularities that enables employees who report information to remain anonymous. The Sarbanes – Oxley Act has caused corporations to review corporate governance and many organizations are responding by implementing an anonymous employee fraud hotline to meet this requirement.

Organizations are choosing either to administer the intake of reports themselves or outsource the intake of reports to an external agency. The internal intake requires the organization to implement a system and use internal resources to administer the call intake and reporting function. The second option is to outsource the call intake of reports to an external agency that provides the system and resources to document tips and communicates the tips received to the organization. These companies provide a service which allow employees and third parties to anonymously and confidentially report incidents of wrong doing, concerns, suggestions and ideas for process improvements through an external service provider and then the reports are forwarded on to the organization for investigation and follow up. The organization is then responsible for the analysis, investigation, resolution and reporting using internal processes.

Fraud and Waste Hotlines in Canadian Cities

Fraud and Waste hotlines have been implemented in a number of cities across Canada. The larger Canadian cities with established hotlines in place and who report information on an annual basis regarding the hotline operations are: Calgary, Edmonton, Ottawa, Toronto and Windsor. Montreal recently implemented an ethics hotline in December 2009 which is administered by the Office of the General Auditor. Toronto and Windsor both manage their hotlines internally through their Audit Departments. Calgary, Edmonton, Ottawa and Montreal have outsourced the intake of the reports to an external agency which operates a call centre and intakes the calls to the hotline and reports on the tips received. The Audit departments in all cities review all incident reports and assign investigations to audit staff or forward the report to the appropriate department manager for their review.

The following is a summary of the operations of the hotlines in the above mentioned Canadian municipalities:

	Toronto	Windsor	Calgary	Edmonton	Ottawa
Year Fraud and Waste hotline implemented	2002	2004	2007	2007	2005
External/Internal	100% Internal	100% Internal	Report intake is outsourced	Report intake is outsourced	Report intake is outsourced
Hotline available to Staff and/or Public	Staff and Public	Staff and Public	Staff and Public	Only City Staff	Staff and the Public
Department that manages the hotline	Audit Department	Audit Department	Audit Department	Audit Department	Audit Department
Number of staff assigned to management of hotline	5 FTE hotline staff and .5 FTE administrative staff	1 Full Time Position	2 Full Time Position	Approximately .74 FTE	1 Full Time Position
Estimated Annual cost	Approximately $550,000 for salaries	Budget dollars have not been specifically allocated for the hotline Estimate 17% of Audit Department resources	$50,500 (External Agency)	$21,000 (External Agency)	$30,000 (External Agency)

Number of Calls Received

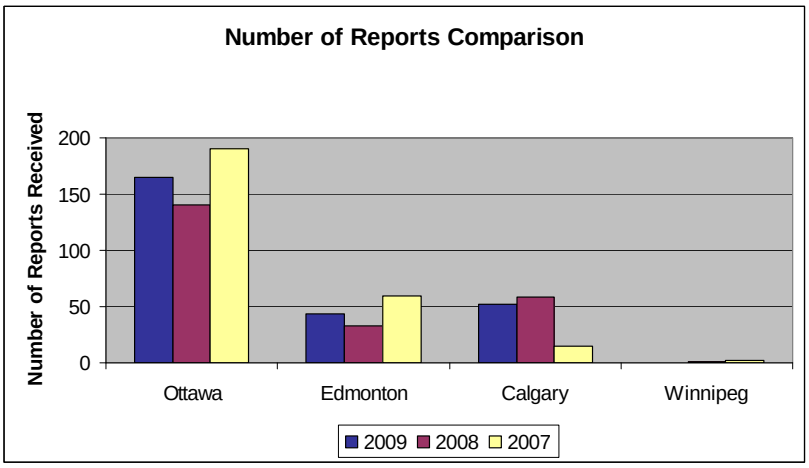
We were able to review Fraud Hotline Activity Reports issued by the Auditor's of Toronto, Calgary, Edmonton and Ottawa. This information was not available for the City of Windsor as they do not publicly report this information.

	Toronto	Calgary	Edmonton	Ottawa
Reports received Year – number of reports	2009 – 677 2008 – 619 2007 – 523 2006 – 503 2005 – 577 2004 – 347 2003 – 238 2002 – 157	2009 – 52 2008 – 59 Jul 1 – Dec 31/07 – 15	2009 – 44 2008 – 33 2007 – 60	2009 – 165 2008 – 140 2007 – 190 2006 – 135 2005 – 48
Investigations initiated in 2009	51	20	16	5 audits initiated The number of investigations not documented

The Auditor's were able to identify a number of benefits that resulted from the implementation of the fraud and waste hotline. The benefits include: a strengthening of controls and improvements to the operational practices and procedures, the identification of the misuse of city property and ensuring a strong ethical culture.

Further to our review of other Canadian cities, we compared the number of reports received in other Canadian cities comparable to the size of Winnipeg, such as Edmonton and Ottawa, to the number of reports received

related to the City of Winnipeg Fraud, Theft or Related Irregularities Administrative Standard which had two incidents reported in 2007, one incident reported in 2008 and none reported in 2009.



Through this review we identified that the number of reports received by other Canadian cities significantly outnumbers the number of reports received in Winnipeg. This comparison leads us to believe that it is likely that a number of possible fraud and waste incidents are going unreported due to the requirements in the City of Winnipeg standard to report to the supervisor with no reference to anonymity. This furthermore leads us to conclude that the current fraud directive is not effective at encouraging employees to report any incidents of fraud, waste or related irregularities.

Losses and Outcomes of Reports

The actual losses by each City related to the frauds identified through a fraud and waste hotline are difficult to determine and in the majority of cases are not publically reported on. Toronto is the only city that has this information available to the public.

In 2009, the City of Toronto reported that the actual quantifiable loss experienced from the reports received in 2009 was $590,067 and the total recovered was $2,329. These amounts were reported in January 2010 and can change as the complaints are further investigated.

The annual losses from the prior years are reported on as well, the following is a summary of the value of the losses at December 31, 2009 and the associated recoveries with the losses in the applicable year.

City of Toronto	2008	2007	2006	2005
Loss as at Dec 31, 2009	$261,420	$190,178	$200,650	$448,269
Recovery as at Dec 31, 2009	$30,155	$80,125	$43,269	$277,257

Annually, the Audit Department in each major city with a fraud and waste hotline, reports on the operations of the hotline, the issues identified and the outcomes associated with any investigations that were initiated. The investigations are summarized and discussed in the annual report on the hotline activity.

The following are the type of incident reports that have been substantiated and resulted in an investigation:

- Overcharging for work completed
- Misuse of City property, funds and resources

- Theft of cash
- Inappropriate usage of email
- Irregular Benefit Claims
- Irregular work hours
- Conflicts of Interest
- Improper purchasing practices

OPERATION OF FRAUD AND WASTE HOTLINES

Audit Department Role

Our research indicates that The Audit Department's role with respect to the fraud and waste includes:

- monitoring and documenting all complaints received through the telephone Hotline;
- making a determination as to the disposition for all complaints received and action to be taken;
- performing preliminary enquiries regarding potential investigations;
- establishing and streamlining Hotline Program procedures;
- coordinating the marketing and communication of the Hotline Program
- report annually on the activity of the hotline and the outcomes and incident reports received during the year

Incident Report Intake

All fraud and waste hotlines implemented in Canadian Cities are administered by the City Audit Department. The intake of incident reports are either handled internally or outsourced to an external agency.

Toronto and Windsor have implemented hotlines where the audit department administers the intake of the reports internally. To administer a hotline internally, Audit Department resources are required to operate the hotline, resources would be reallocated from audit projects to the operation of the hotline which would include:

- receiving calls during regular business hours;
- reviewing messages received after hours on voicemail;
- documenting and reviewing all reports received;
- determining the appropriate course of action required to address the report whether it be to conduct an investigation or forward the report to the appropriate department for their information; and
- conducting any investigations required.

A disadvantage with the intake of reports administered by the Audit Department is that calls would only be received by a person during regular business hours. All calls received after business hours would be forwarded to voicemail for the caller to leave a message. This could potentially limit the amount of information received by the caller as the caller may not provide all the necessary information.

Edmonton, Calgary and Ottawa have outsourced the call intake function and receive a report from an external agency providing this service which details the information received from callers. Once the information is received, the audit department reviews the information and determines if an investigation should be conducted or if the information should be passed on to the applicable department's management or the incident reported is dismissible.

There are numerous advantages to using an external agency to intake the calls. With a fraud and waste hotline, the line needs to be available 24 hours a day as research has shown that nearly 50% of hotline calls occur outside of regular business hours. The need for human interaction is also critical when dealing with an

anonymous caller because there may never be another chance to fully document the report. The operators with the external agencies are properly trained and the interactive communication between a caller and the operator will generate more detailed information that is required to deal with the tip than one-way communication such as a message on a voice mail or an anonymous note. An external agency will also maintain statistical data regarding the volume and nature of calls received.

External agencies, provide web and telephone based systems that are accessible 24 hours a day, 7 days a week, 365 days a year and have the ability to provide their services in English and French.

Additional advantages of outsourcing the report intake function include:

- Increased assurance of anonymity of the reporter;
- The external agency will provide the software and related tracking capabilities necessary to support the incident reports and follow-up actions;
- Costs of using an external agency can be less than the resources required to support the function internally.

Full support for the fraud and waste hotline is required from management throughout the organization. Depending on the reports received, the Audit Department would need to work with management in the applicable departments or refer the issue to management for resolution. Resources or involvement would be required by all departments across the organization to ensure the successful implementation of the hotline and to ensure reports are dealt with in a consistent manner.

The City Auditor is responsible for the operations of the hotline with the audit department being required to review, investigate and monitor all activities until the files are closed.

Costs to Operate

We estimate the cost of outsourcing the intake of the calls would be approximately $25,000 annually. The cost of using an external agency for the intake of calls is based on the number of end users (usually employees) of the service. In addition to this cost, resources from the audit department are required to administer the reports and review each report to determine the course of action to be followed. Fewer internal resources are required in the case where the call intake function is outsourced to an external agency. The City of Edmonton allocates .74 of an FTE, Calgary has allocated 2 FTE's and Ottawa has allocated one FTE to work on the reports received through the hotline as they have outsourced the call and internet intake of reports.

The City of Toronto receives the largest number of reports and administers all functions of the hotline through the Audit Department including the intake of calls. As a result they have dedicated five FTE hotline staff plus .50 FTE for administrative assistance for administering the intake of calls, responding and investigating incident reports.

With the implementation of the fraud and waste hotline, the audit departments have either absorbed the costs of operating the hotline into their current budgets or depending on the extent of the line and the resources required some budgets have been increased to allow for the operation of the line. Calgary and Edmonton absorbed the costs of implementing the hotline into their budgets while Ottawa increased their budget by $200,000 to implement the new hotline.

Implementation and Communication

An important element for the successful implementation of a fraud and waste hotline is the communication of the hotline. A separate policy for the hotline should be developed outlining the procedures and responsibilities of management and staff related to reporting fraud. Policy statements regarding whistle-blower protection within the fraud and waste hotline policy should be developed to demonstrate the City's intention to protect its

staff from retaliation by both co-workers and management. Communication during the planning and the implementation of the hotline is especially important with all staff and unions.

Educating employees and raising awareness regarding the purpose of the hotline and how it functions is important to ensure employees are aware of the hotline and feel comfortable reporting any information. With the implementation of the hotline it is important to establish an effective ongoing communication strategy that promotes the hotline as part of the organization's overall program for encouraging ethical behaviour and preventing instances of fraud. The communication should educate and motivate employees to report their concerns through the available communication channels. Communication of the hotline is an ongoing task as to continuously remind employees of its function.

Once the hotline is operating it is important to follow up on each report that is received and respond to the individual who reported the incident with the status or a response from the Audit Department if this is requested. The external agency provides this service and will update their records with the responses from the organization to communicate to the tipsters. This is an important part of the hotline as employees will not value the hotline if they believe or perceive that the tips are not being investigated.

CONCLUSION AND RECOMMENDATIONS

The City of Winnipeg is committed to protecting its revenue, property, information and other assets and as such the City has implemented various policies and administrative standards regarding code of conduct, fraud, theft and related irregularities. The methods of reporting any suspected acts of fraud, theft, misappropriation, breaches of the employee code of conduct or other related irregularities are reasonable, however the research conducted indicates that additional measures are likely to be successful in increasing employee comfort levels and willingness to report misconduct. Since the implementation of the City of Winnipeg Fraud, Theft or Related Irregularities administrative standard in 2006 there have been 3 reports from employees compared to 44 reports from employees via the fraud and waste hotline in Edmonton in 2009. An anonymous telephone fraud and waste hotline has been implemented in cities across Canada and has resulted in fraud and waste being identified through anonymous reports from employees.

Upon approval, The Audit Department would assume responsibility for leading the implementation of the hotline and would outsource the call intake function. The Audit Department would propose to absorb the costs for an external service provider within the department's current approved budget. Upon implementation, the audit department staff resources would be required to review all reports and when required investigate the report further. The Audit Department would review the report and if required distribute to the management in the appropriate department for resolution. In addition, depending on the type of reports that are received Corporate Support Services or Legal Services may be required to assist in the review and resolution of the complaint or report.

The implementation of a fraud and waste hotline supports financial accountability, the integrity of the City of Winnipeg employees and the workplace and serves as a deterrent to fraud. The hotline also supports the protection of city property resources and information. The implementation of a hotline demonstrates the City's commitment to sound and ethical operating practices.

Recommendations:

1. That the Audit Committee recommends to Council that the Audit Department implement a Fraud and Waste Hotline to be managed by the Audit Department.

2. That the Audit Department in consultation with other City Department management and corporate stakeholders as required, do all things necessary to implement a fraud and waste hotline.

3. That the Audit Department develop a policy/administrative standard outlining the purpose, procedures and responsibilities for a fraud and waste hotline.