

# TORONTO STAFF REPORT

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September 3, 2003

To: Audit Committee

From: Auditor General

Subject: Annual Report on the Status of Fraud and Related Matters,  
Including the Operation of the Fraud & Waste Hotline Program

Purpose:

To submit to the Audit Committee an annual report on the status of fraud and related matters, including the operation and activities of the Fraud & Waste Hotline Program, as requested by the Audit Committee.

Financial Implications and Impact Statement:

Investigations conducted by the Auditor General (related to suspected fraud or irregular activity involving City resources), as summarized in this report, have or may result in the recovery of funds to the City. In addition, recommendations made to management resulting from these investigations should minimize the risk of fraudulent activities and other improprieties, thereby mitigating potential losses to the City.

Recommendation:

It is recommended that this report be received for information.

Background:

This report represents the Auditor General's annual report to the Audit Committee on the status of fraud and related matters, including the operation and activities of the Fraud & Waste Hotline Program.

The Fraud & Waster Hotline Program:

The Fraud & Waste Hotline Program (the Hotline Program) is an ongoing initiative administered and operated by the Auditor General's Office. The Hotline Program began as a six-month pilot starting March 1, 2002, with operation continuing after the pilot ended. City Council approved it

as a permanent program in November 2002. At that time, no additional resources were requested to operate the program. However, we indicated that we would absorb the additional workload while continuing to monitor the level of audit resources required and request any additional funding during the 2004 budget process. This allowed us to monitor and assess the level of Hotline activity over a longer period of time.

#### Investigations:

Since we last reported on the status of fraud and related matters in September 2002, my office has continued to conduct a number of forensic audits. These forensic audits have involved the investigation and collection of evidence related to suspected fraudulent or irregular activity perpetrated by City employees and, in some cases, by external third parties.

While the Auditor General takes the lead role in conducting these investigations, they are conducted in consultation with appropriate City Legal, Human Resources and departmental staff. In cases where there is sufficient evidence, the Toronto Police Service is contacted. My office has worked co-operatively with the Toronto Police Service to ensure that evidence is documented to a level that is sufficient to substantiate the laying of charges. Where charges have been laid, Audit staff have appeared as witnesses at court proceedings.

Currently, incidents of fraud or other improprieties are brought to the attention of the Auditor General by City staff, suppliers or the general public. Suspected incidents of fraud or other irregularities may be reported to the Auditor General directly by City management, City staff, by mail or through the anonymous Fraud & Waste Hotline Program. The Auditor General may also identify incidents in the course of conducting audits.

#### Comments:

##### Operation of the Fraud & Waste Hotline Program by the Auditor General

The Fraud & Waste Hotline Program was set-up with 24-hour voice mail, within the Auditor General's Office, and designated as an anonymous telephone resource for callers to report suspected incidents of fraud or other similar irregularities. The Hotline Program is currently being expanded to permit the anonymous reporting of complaints on-line. This on-line application not only provides the on-line form as a reporting vehicle, but it is also a database solution for managing all complaints received by the Auditor General's Office. Appendix A provides further information relating to the administration of the on-line reporting process.

Operation of the Hotline Program includes the administration of complaint intake, electronic tracking of complaints and the disposition of complaints received. These complaints in turn may result in no action, referrals to departments or investigations being conducted. Complaints received are screened by designated Audit staff and appropriately investigated in accordance with internal protocols, procedures and guidelines.

Summary of Complaints Received – September 1, 2002 through to August 31, 2003

The following table provides a summary of the source and disposition of complaints received by the Auditor General’s Office from September 1, 2002, through to August 31, 2003:

Source of Complaints	
Fraud & Waste Hotline (telephone)	137
Letters	53
Other Sources (e.g., departmental contacts)	10
<b>Total Complaints Received</b>	<b>200</b>

Disposition of Complaints	
<u>No Action Taken</u> (Not enough information is provided to support allegations.)	66
<u>Referral to Departments</u> (Requests to Management to review allegations and report to the Auditor General's Office on actions taken by department.)	114
<u>Investigations</u> (Includes ongoing investigations.)	8
<u>Referrals to Outside Agencies</u> (City’s Social Services and Provincial/Federal agencies.)	10
<u>Preliminary Enquiries Being Made</u>	2
<b>Total</b>	<b>200</b>

Every complaint received regarding suspected fraud, waste or other irregular activity, whether it is brought to the Auditor General’s attention through the Hotline Program or otherwise, is dealt with pursuant to the Auditor General's Office approved mandate and in accordance with the City of Toronto’s Policy on Fraud and Other Similar Irregularities (the Fraud Policy).

In certain cases, due to the nature of the allegations, complaints are referred to City departments, with a request that management conduct a review of the allegations and report back to the Auditor General’s Office on any action taken.

Complaints referred to departments include such matters as allegations of unwarranted overtime, allegations of inappropriate hiring practices, unauthorized personal use of City assets and complaints regarding City services. Responses from City staff are evaluated by the Auditor General’s Office in order to determine whether additional action may be required.

Staff Resources Utilized to Operate and Administer the Fraud & Waste Hotline Program

During the course of the Hotline Program’s first year as a permanent program, the amount of staff time employed to operate and administer the Hotline Program included:

1. monitoring and documenting all complaints received through the telephone Hotline, by letter or otherwise;

2. making a determination as to the disposition for all complaints received and action to be taken;
3. performing preliminary enquiries regarding potential investigations;
4. establishing and streamlining Hotline Program procedures; and
5. coordinating the marketing and communication of the Hotline Program.

The total amount of staff time utilized on the foregoing activities was approximately 1200 hours.

Complaints received resulted in the commencement of eight investigations. The total number of hours spent by staff on these investigations, over the course of the last year, was approximately 1500 hours.

#### Cost of a Permanent Hotline

The Auditor General's Office accommodated the operation of the Fraud & Waste Hotline Program (including marketing and communications) during its first year as a permanent program, within its 2003 approved budget. This was done with a view to monitoring audit resources required to operate the Hotline Program and conduct investigations, and request any additional funding during the 2004 budget process (as previously indicated in our report dated November 6, 2002, entitled "Fraud Hotline – Six-month Pilot Project", which recommended the permanent establishment of the Fraud & Waste Hotline Program).

In anticipation of the 2004 budget process, we recently advised the Audit Committee that additional funding would be required for the Auditor General's Office to effectively carry out its mandate and audit activities, including operation of the Hotline Program (as indicated in our report dated June 26, 2003, entitled "Auditor General's Office 2004 Operating Budget – Potential Funding Implications").

Based on our analysis of staff resources used to operate the Hotline Program and administer the volume of complaints received over the course of its first year as a permanent program, two additional full-time staff equivalent, costing a total of approximately \$160,000 per year (plus benefits), would be required to operate a permanent Hotline Program and investigate complaints received.

#### Benefits of the Permanent Fraud & Waste Hotline Program

The permanent Hotline Program has provided several benefits. One of the key benefits of the permanent Fraud & Waste Hotline Program is that complaints received have resulted in actions that have reduced losses attributed to incidents of fraud, waste or other irregularities by terminating substantiated incidences, and by strengthening controls to reduce the risk of future losses.

Even when a finding of fraud or irregularity is not substantiated, investigations conducted have identified areas where internal controls need to be modified or enhanced (with a view to improving City operations) or have resulted in enhanced protection of City resources. For example:

1. Improper Assignment of Lease:

Concerns brought to the Auditor General's attention through the Hotline Program, resulted in a determination that certain issues warranted further attention, prior to the City consenting to the assignment of a lease (related to the use of City property). Our Office addressed these issues as they pertained to the proposed terms of assignment, in consultation with appropriate City departments, including Legal Services. Consequently, this resulted in enhanced protection of City resources and monies paid by City residents on deposit to the original assignor of the lease.

2. Use of Internet by Employee to View Inappropriate Sites

Allegations regarding the use of the Internet by an employee to view inappropriate sites was brought to the Auditor General's attention through the Hotline Program. Consultations with City departments have resulted in the City reviewing the need for Internet filters to prevent all employees from reviewing inappropriate material on the Internet.

Communication Strategies for a Permanent Hotline

A formal communication strategy was developed in consultation with the City's Corporate Communications Division, to appropriately promote the permanent Fraud & Waste Hotline Program to City staff, suppliers and the public.

Communication initiatives employed during the first year of the permanent Hotline Program have included e-mail/fax communications to City employees, information on the City's internet/intranet sites and development of a Hotline poster. Appendix B outlines the specific communication initiatives employed during the first year of the permanent Hotline Program.

Continued communication of a permanent hotline is essential to its effectiveness. We have continued to develop communication strategies, in consultation with the City's Corporate Communications Division, to appropriately promote the permanent Fraud & Waste Hotline Program to City staff, suppliers and the public.

Communication strategies to promote the existence of the permanent Hotline Program have been combined with initiatives to enhance awareness of the City's Fraud Policy (which was done throughout the original Hotline pilot project).

Marketing and communicating the existence of a hotline should be viewed positively. If marketed effectively, a hotline will convey to employees, the public and anyone doing business with the City, that the City of Toronto is committed to ethical conduct and takes the detection, reporting and prevention of fraud seriously.

## Investigations

Summarized below is the status of investigations conducted by my office in the last year, followed by the status of those investigations previously reported to the Audit Committee, in our report dated September 4, 2002, entitled "Annual Report on the Status of Fraud and Related Matters," that are still outstanding or have recently been closed.

### Status of Investigations

The status of investigations conducted by the Auditor General, over the last year, is as follows:

#### 1. Duplicate Payments

Alleged irregularities in processing grant payments for sewer service line repair/replacement were brought to the Auditor General's attention by a Councillor. The matter was brought to the Councillor's attention by a City of Toronto resident who also alleged that a City Works employee had deliberately recommended a selected contractor to do the required blocked sewer repair for him and his neighbours.

Our investigation found no conclusive evidence to substantiate the allegation that the inspector deliberately recommended the selected contractor to ensure that this firm received business from these residents. Our review, however, identified fundamental key control weaknesses in the administration of the program and found three duplicate payments totalling \$4,500 in our sample review. The matter was referred to Works senior management for immediate corrective action. We have been advised that controls have now been implemented in drain grant administration procedures to prevent future duplicate or overpayments.

At the request of audit staff, Works senior management is conducting a full review of the drain grant program and its approval process. Based on source documents reviewed to date, Works has identified additional duplicate grant payments totalling approximately \$25,500. Works Financial Services has advised us that steps have been taken to recover these duplicate payments.

#### 2. Irregular Purchasing Activities

An investigation was conducted to review a number of allegations made by the principal of a company with respect to the procurement of services by a City department.

Our review of the procurement of services for City events during 2002 and 2003 found no evidence to support the allegations that:

- the contracts were awarded before a Request for Proposal was officially issued for these services; and

- specifications (business arrangements) had been intentionally structured to favour one particular supplier or to impose restrictions on the ability of other suppliers to respond.

However, as a result of the investigation, several recommendations were made to improve processes and enhance controls over the procurement of these services within the division.

### 3. Irregular Purchasing Activities – Conflict of Interest

An investigation was conducted to review a number of allegations received through the Fraud & Waste Hotline, which included irregular purchasing activities by a departmental Materials Management Supervisor.

Our review of this matter indicated that the Supervisor had conducted himself in a manner which compromised his objectivity (for example, by personally completing the vendor's request for proposal documents and depositing City cheques paid to the vendor, on her behalf). The investigation concluded that the Supervisor had breached the City's Conflict of Interest Policy by directing purchases, totalling approximately \$5,000, towards a particular vendor. The employee has been terminated.

### 4. Fair Wage Office

A City manager has been charged with accepting a secret commission from a supplier. The employee has been terminated. The Auditor General's Office is in contact with the police regarding the status of the ongoing police investigation.

### 5. Court Services – Obstruction of Justice

The Auditor General's Office was advised by the Director of Court Services that the Toronto Police Service had been contacted to investigate the disappearance of numerous Provincial Offence's Act Informations. The employee was charged by the Toronto Police Service and the Police investigation is continuing. The employee has been terminated.

## Status of Investigations Previously Reported

The status of investigations conducted by the Auditor General, previously reported to the Audit Committee in September 2002, that are still outstanding or have recently been concluded, are as follows:

### 1. Workplace Safety and Insurance Board Claims – Unsubstantiated Fraudulent Disability Claim – Recommendation to Improved Administrative Deficiencies

A City employee on long-term disability, formerly with Works & Emergency Services, is alleged to have been observed performing physical work that draws into question the

validity of his disability claim. A caller reported this allegation to the City's Fraud & Waste Hotline. The Auditor General's Office referred the investigation to the Workplace Safety and Insurance Board (WSIB).

This matter was investigated by WSIB officials who determined that the individual was engaging in activities consistent with rehabilitation of his condition. The investigation file has been closed and Finance has been advised of the need to ensure that certain administration deficiencies such as regularly required medical certificates are obtained.

2. Excessive Overtime

A City employee is alleged to have submitted false overtime hours for the past 18 months. A caller reported this allegation to the City's Fraud & Waste Hotline. Our review determined that this employee had recorded significant overtime in both 2001 and 2002 (\$69,000). Our investigation found there had been no authorization of this employee's timesheet submission, and a lack of supervisory review and control by his supervisor. Proper controls have since been implemented.

The employee was terminated as a result of his actions. This matter is currently under review through arbitration hearings as the employee filed a grievance with respect to his dismissal.

A determination was made by the Toronto Police Service that criminal charges would not be pursued.

3. Permit Fraud – Misappropriation of Funds

Irregularities in permit issuances by an employee in the Economic Development, Culture and Tourism Department were brought to the Auditor General's attention by senior management in the department. An employee brought this matter to management's attention. Our investigation confirmed that the employee used his access privileges to the computerized permit booking system to apply reduced rates to ice time for his hockey group. Further, the employee tentatively booked and subsequently cancelled the contracts without making payments to the City, despite the usage of ice time and the collection of monies from the other hockey players.

Records were available to substantiate fraudulent activities dating back to February 2000 and approximately \$9,000 was misappropriated. This investigation has been completed and senior management has been advised of our findings. The matter has been referred to the Toronto Police Service and criminal proceedings are pending. The employee was terminated.

4. Misappropriation of Funds

Audit staff was advised by the Director of Court Services that the Toronto Police Service had been contacted to investigate a suspected cashier fraud. The employee was

suspended without pay, pending completion of the Toronto Police Service investigation. This investigation is ongoing and charges are pending.

The initial incident revolved around a customer who had paid a \$4,448.75 fine in cash to the City and was subsequently advised by the Ministry of Transportation that his license was still under suspension. The cashier claimed she had refunded the money.

A subsequent incident surfaced when a second customer also complained that they had paid \$4,400 in fines and could not renew their license at the Ministry because the records indicated that fines were outstanding. Court Services staff found three additional irregular transactions for \$11,000, bringing the total cash losses to approximately \$20,000. Based on victim statements and other evidence, the employee was terminated. Court Services have now implemented procedural changes respecting the authorization of all refunds, which now require approval of the Senior Clerk and/or the supervisor.

5. Misappropriation of Funds

The Auditor General continues to work with the Toronto Police Service on a suspected fraud at a City arena, operated by a Committee of Management. This fraud was identified by Audit staff and involved the misappropriation of approximately \$100,000 by an employee, from 1998 to 2000. The employee has been terminated and formally charged by the Toronto Police Service. Court proceedings are continuing and Audit staff will provide evidence during these proceedings.

6. Misappropriation of Funds

In early 2001, we were contacted by a regional police service in connection with an investigation that they were conducting. In conducting its investigation, the regional police service encountered certain irregularities related to a City of Toronto cheque.

During Audit Service's staff follow-up of this matter, a number of concerns were identified which indicated that City Works and Emergency Services staff may have been authorizing the issuance of inappropriate cheques in late 1999 and early 2000 to third parties. A review was conducted and we identified the source of the authorization of these cheques. The amount in question was determined to be in the range of \$125,000. Detailed evidence was forwarded to the Toronto Police Service to support the laying of charges. Court proceedings have concluded with respect to one City employee, since terminated, who was ordered to pay the City approximately \$50,000 in restitution.

Two other individuals (who are not City employees) have been implicated in this matter, and one of them was ordered by the court to pay the City \$3,000 in restitution. The Toronto Police Service investigation continues in this matter with respect to a fourth suspect (also not a City employee).

Other investigations are currently in progress and will be reported to Audit Committee at a later date.

Conclusions:

The Auditor General's Office reviews and makes recommendations for improved internal controls through the completion of regular audits and forensic investigations. The Auditor General has reported on the results of completed investigations to the respective Commissioners. These reports include recommendations to improve internal controls to minimize the recurrence of such incidents. Recommendations have been implemented or are in the process of implementation. The Chief Administrative Officer and the Chair of the Audit Committee have been kept informed of all instances of employee fraud or other irregularity.

The primary responsibility for maintaining appropriate internal controls to prevent and detect fraud or other irregularity involving City resources remains with departmental management. In particular, appropriate and adequate supervision is an important component of administrative internal control.

My office continues to work with the Chief Administrative Officer and department heads to increase the level of awareness among City employees with respect to the identification and reporting of fraud and other improprieties involving City resources. Recent communication efforts have focussed on making staff and outside parties aware that the City of Toronto has a management strategy for promoting accountability and ethical business practices, which includes a Fraud Policy and a Fraud & Waste Hotline Program (anonymous telephone resource and on-line complaint form).

All City of Toronto staff have a responsibility to report improper activity involving City resources, pursuant to the City's Fraud Policy. The existence of a Fraud & Waste Hotline Program has enhanced City staff's awareness of potential frauds or other irregular activity and their responsibility to report and prevent it.

Additional funding will be requested to continue operation of the Fraud & Waste Hotline Program, which requires dedicated resources to ensure it is properly operated and complete resulting investigations. Based on the analysis of staff resources used during 2002 and 2003 to operate the Fraud & Waste Hotline Program and administer the volume of complaints received, an additional two full-time staff equivalent, costing approximately \$160,000 per year (plus benefits), would be required. This increase in funding will be requested through the 2004 budget process.

One of the key benefits of the Fraud & Waste Hotline Program is that it may help reduce losses attributed to fraud and other irregularities by terminating substantiated incidences of fraud, and by strengthening controls to reduce the risk of future losses.

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List of Attachments:

Appendix A: Description of On-line form – Fraud & Waste Hotline – City of Toronto  
Appendix B: Communication Strategies for the Permanent Fraud & Waste Hotline Program

Description of On-line Form – Fraud & Waste Hotline – City of Toronto

The Fraud & Waste on-line form was developed by staff of the Auditor General's Office and Web Management Services (in consultation with the City's Privacy Office) to expand the City's Fraud & Waste Hotline Program.

This application not only provides the on-line form as a reporting vehicle, but it is also a database solution for managing all complaints received by the Auditor General's Office.

While members of the public can input their complaints via the Internet using the secure SSL-encrypted on-line form, designated staff of the Auditor General's Office can also input all other complaints received from all other sources or reporting vehicles, such as the Hotline telephone line, by mail, and those referred from other City departments.

Audit staff who are authorized, registered and authenticated can login using a browser from any Intranet workstation to:

- i. update and sort complaints by status (closed or outstanding); and
- ii. view totals-to-date (all by source of complaints, and by disposition) by department, by type of complaint and more.

If a complaint has been referred to another City department or agency, and staff have inputted a follow-up date, an automatic mail agent will send a reminder to Audit staff if the complaint is still outstanding on the follow-up date.

The database is full-text indexed for searching and resides on a Sun Server running IBM Lotus Domino.

Complaints received via the Internet are copied to an internal server, then, as a security measure, are deleted from the Internet server.

The Fraud & Waste Hotline application stores all complaint information in one place, thereby enabling Audit staff to efficiently manage and report on all complaints reported to the Fraud & Waste Hotline Program.

### Communication Strategies for the Permanent Fraud & Waste Hotline Program

The objective of communication efforts for the permanent Fraud & Waste Hotline Program was to make audiences aware that the City of Toronto has a management strategy for promoting accountability and ethics, which included a formal Fraud Policy and a Fraud & Waste Hotline Program.

Communication efforts for the permanent Fraud & Waste Hotline Program included the following:

#### General Communications

- Development of a formal Communication Plan, in consultation with the Corporate Communications Division; and
- Continued use of visual/graphic identifier (telephone image with hotline number) which provides a symbol that is readily associated with the Hotline and adaptable for reproduction in various publications.

#### Internal Communications

- Chief Administrative Officer/Auditor General e-mail/fax message to all City Staff announcing Council's approval of the Fraud & Waste Hotline as a permanent program;
- Continued reproduction of the visual/graphic identifier in Inside Toronto, City's corporate newsletter;
- Visual/graphic identifier with heading forwarded to City departments for inclusion in departmental newsletters;
- Council's decision on the permanent Hotline was included as an item in Council highlights (an information document that provides summaries of select Council decisions) that is posted on the City's Internet site. This document is also distributed to Senior Management, Members of Council and community media groups;
- Development of a poster (distribution to all City departments and ABCs, Councillors and the Chief Administrative Officer – target date, September 2003); and
- Information about the Fraud Policy and Hotline on the City's Intranet site.

External Communications

- News release to all Toronto media regarding Council's decision on the permanent Fraud & Waste Hotline;
- Article on Fraud & Waste Hotline Program forwarded to City Councillors for inclusion in constituency newsletters or communications;
- Presentation at North American Local Government Auditor's Conference (hosted in Toronto by the Auditor General's Office); and
- Information about the Fraud Policy and the Hotline on City's Internet site.