

Clause embodied in Report No. 3 of the Audit Committee, as adopted by the Council of the City of Toronto at its meeting held on February 13, 14 and 15, 2002.

2**Fraud Hotline - City of Toronto**

(City Council on February 13, 14 and 15, 2002, adopted this Clause, without amendment.)

The Audit Committee recommends that:

- (1) the following report (January 22, 2002) from the City Auditor be adopted; and**
- (2) all staff be advised that staff and City contractors are not restricted to the fraud/audit hotline, but are also entitled to speak to a Member of Council.**

The Audit Community Council submits the following report (January 22, 2002) from the City Auditor:

Purpose:

To report to the Audit Committee on the implementation of an employee fraud/waste hotline in the City of Toronto, as requested by the Audit Committee.

Financial Implications and Impact Statement:

Additional funding may be required to operate a fraud/waste hotline and complete the resulting investigations, depending on the volume of calls received and the incidents of suspected fraud/waste reported and investigated.

Recommendations:

It is recommended that:

- (1) the City Auditor establish and operate a fraud/audit hotline on a six-month pilot project basis;**
- (2) the City Auditor report to the Audit Committee, at the end of the pilot project, on the feasibility of establishing a permanent fraud/audit hotline in the City of Toronto; and**
- (3) the City Auditor be given the authority to continue to operate the hotline after the six-month period, as appropriate, until a report on the permanent establishment is considered by Council.**

Background:

At its meeting of December 14, 2001, the Audit Committee requested the City Auditor, in consultation with the Chief Administrative Officer, to report to the Audit Committee, “on how a City employee fraud/waste hotline could be implemented in the City of Toronto, similar to other large municipalities.”

In conducting this review, Audit staff:

- surveyed Canadian and American municipalities by telephone and by researching municipal, provincial and federal web sites on the Internet;
- reviewed the City’s existing fraud policy, audit procedures, past audit reports related to fraud and related information on the City’s web and Intranet sites;
- consulted third-party hotline service providers and contacted client references; and
- conducted general research on fraud hotlines through the Internet and a review of related literature.

Comments:

Combating Fraud in the City of Toronto

The following initiatives have been undertaken to date to minimize the risk of fraudulent activity in the City:

- the establishment of a formal Conflict of Interest Policy which applies to all City of Toronto employees (approved by Council on August 4, 2000);
- the establishment of a formal policy on fraud entitled “Fraud and Other Similar Irregularities” approved by Council on April 23, 2001 (pursuant to the City Auditor’s report that recommended a formal policy related to fraud), that clarifies the roles and responsibilities of all City staff in dealing with suspected fraudulent activity;
- the City Auditor has reviewed and made recommendations for improved internal controls through the completion of regular and forensic audits. Since amalgamation, City Audit Services has conducted a number of forensic audits involving the investigation and collection of evidence relating to suspected fraudulent activity;
- the enhancement of management’s awareness regarding the prevention and detection of fraud. In April/May 2001, Council adopted the City Auditor’s report titled “Management Controls: A Basic Departmental Responsibility”, which was issued to ensure management understood their responsibility in the prevention and detection of fraudulent activity and to emphasize the need to continually evaluate the City’s internal controls; and
- the City Auditor has conducted employee anti-fraud awareness and education sessions.

Reporting Fraud in the City of Toronto

Fraud detection and reporting are important to any system of fraud prevention and deterrence. An anonymous telephone fraud hotline is one way to facilitate reporting and provide a centralized reporting mechanism.

Currently, incidents of fraud are brought to the attention of the City Auditor's Office directly by staff, suppliers or the general public, while others are identified by the City Auditor.

The City's Policy on Fraud and Other Similar Irregularities (Fraud Policy) outlines the procedures that should be followed by staff with respect to the reporting of suspected fraudulent activities in the City.

This policy is available on the City's Audit Services' web page, and has been posted on the City's Intranet site. Recently, the Chief Administrative Officer forwarded a copy of the Fraud Policy to Commissioners, with instructions to circulate the policy to each of their respective managers. A memorandum that outlines the internal control issues that staff should consider was also provided. This was done to promote awareness of the City's Fraud Policy. Establishing and effectively marketing a fraud hotline may further assist in this regard.

Existing Municipal Fraud Hotlines

The City's Social Services Division initiated and has operated a welfare fraud hotline since 1992, as a mechanism to monitor client eligibility and to provide the public with an avenue to report alleged instances of social assistance abuse by clients in receipt of assistance. The Province decided that the City's "hotline" was a good mechanism, and in the mid-1990's, the "hotline" concept became part of a broader Ministry of Community and Social Services initiative, whereby central co-ordination of existing municipal hotlines occurred and a province-wide welfare fraud hotline was established.

With exception of this dedicated welfare fraud hotline, no Canadian municipality currently has a general fraud hotline.

In the U.S. however, various cities have established fraud hotlines which they administer internally. For example:

- the City of Seattle's Audit Department has a designated Audit Hotline as a telephone resource for callers to ask questions and share concerns, including incidents of fraud. Seattle advised that it receives only two to three fraud related calls a year (they have a separate Commission dealing with ethics);
- the City of Orlando's Audit Department has also designated their telephone number as an Audit Hotline that is answered by assistants who forward calls to a designated manager. They receive an average of five to seven calls a year;
- the City of Chicago's Inspector General's Office (with a staff of 45) was established to detect, prevent and investigate misconduct, waste and inefficiency in the programs and operations of the City government (43,000 employees). Chicago has a 24-hour Inspector General's Hotline which receives and investigates 150 to 200 calls a year;

- Milwaukee County's Audit Department has a dedicated Fraud Hotline with one dedicated staff member (Certified Fraud Examiner) and back-up assistant auditors. They reported 76 contacts in 2000 concerning allegations of fraud, waste or abuse (40 hotline calls, 14 letters, 11 referrals from departments, seven from audit work and four other). Of the 74 cases that were opened, 56 were closed for a variety of reasons (24 substantiated, 23 not substantiated, four insufficient information, two referred out, four no action required).
- the City of Dallas has a Fraud, Waste, and Abuse Division within its City Auditor's Office, with a dedicated hotline and experienced investigators. The 2001 budget for the Dallas fraud unit is approximately \$180,000. Dallas developed its program from a single hotline to its current program which consists of a telephone hotline (three lines answered by three fraud investigators), plus one voice mail line, an e-mail hotline and a post office box. As well, they market the hotline with business cards, brochures, posters, videos and on employee paycheque stubs.

Last year, Dallas' fraud unit received 855 calls (of which 693 were referred to outside departments and/or agencies, as they were not fraud, waste, abuse related). Approximately 180 of the calls received were assigned to a fraud investigator. Of these: 63 cases were substantiated; 99 were determined to be unrelated to fraud, waste or abuse; and 17 cases were forwarded for criminal investigation, resulting in one criminal charge.

Establishing a Fraud Hotline within the City of Toronto

The City of Toronto could set up a fraud hotline with voice mail within the City Auditor's office. This hotline would be designated as a telephone resource for callers to report incidents of fraud, waste and other improprieties. Calls would be screened by audit staff and those calls related to suspected irregularities would be investigated accordingly.

Marketing initiatives for the hotline could include an introductory letter from the Chief Administrative Officer, advertising on the City of Toronto's Intranet and Internet web sites and on employee pay stubs, as well as inserts in vendor cheques.

Depending on the volume of calls received and the number of alleged incidents of fraud reported and investigated, additional resources and funding may be required to effectively operate this program. In addition, funding may be required to advertise the hotline depending on the marketing strategies adopted.

Using a Third-party Service Provider to Set up and Administer a Hotline

Some private sector organizations we surveyed use third-party service providers to establish and administer their hotlines. Third-party providers basically offer a centralized call centre service, interview callers, prepare initial reports and maintain statistical data regarding the volume and nature of calls received. Their reports would then be forwarded (within a day) to the organization's internal audit department for review and appropriate investigation by audit staff.

Depending on the volume of calls received and incidents of fraud reported, using a third-party provider may not be the most cost-effective method of setting up and administering a hotline (cost is based on number of employees not volume of calls received). While there may be potential savings in terms of the time it takes to interview callers, document interviews and prepare initial reports, audit staff must still review the initial reports and conduct the investigations, as appropriate. It is premature at this time to estimate the cost-effectiveness and value of this service, in the context of a complete fraud hotline program.

Advantages and Disadvantages of Operating a Hotline

Our research has identified the following potential advantages and disadvantages of setting up a City fraud/audit hotline:

Advantages:

- a hotline provides a centralized reporting or communication mechanism for employees to report possible misdeeds;
- investigations resulting from hotline calls may identify areas where internal controls need to be modified or enhanced;
- an anonymous hotline may encourage reporting of internal and external frauds (e.g., by contractors doing business with City) without fear of reprisal;
- a hotline is a good public relations tool, that if marketed effectively, will convey to employees that the City takes ethics (and its Fraud Policy) seriously while conveying to the public (and anyone who does business with the City) that the City is monitoring fraudulent and inappropriate activity; and
- a hotline may assist in deterring fraud by increasing the perception of being detected.

Disadvantages:

- costs associated with fielding all calls (depends on the volume and nature of calls received);
- costs associated with investigating calls;
- City Auditor is required to investigate all potential frauds, but not all calls will lead to substantiated fraud;
- nuisance or vexatious calls, that do not constitute appropriate use of a hotline;
- guaranteeing caller anonymity on the hotline often prevents follow-up. This can be minimized if interviewers are answering the telephone and schedule a call-back time. However, a hotline set up as a 24-hour voice mail service does not allow for this unless the caller leaves a contact number.

Conclusions:

Fraud detection and reporting are important to any system of fraud prevention and deterrence. An anonymous telephone fraud/audit hotline is one way to facilitate reporting and provide a centralized reporting mechanism for City employees who are located in over 2,670 locations throughout the City of Toronto.

One of the stated objectives in formulating the City's Policy on Fraud and Other Similar Irregularities was the need to create an environment and awareness for dealing with issues of fraud. Establishing and marketing a City fraud/audit hotline is consistent with this objective.

The advantages of setting up a hotline include a deterrence factor, by increasing the perception of being detected. Disadvantages include nuisance calls and the costs associated with fielding calls that do not deal with fraud, waste or abuse.

Although no Canadian municipality has established a fraud or audit hotline to combat fraud, various American cities do operate fraud hotlines. All American cities contacted established and staffed their hotlines internally, while some private sector organizations use third-party service providers to set up and administer their hotlines. These third-party service providers answer calls and complete the initial reports, which must then be screened and potentially investigated by audit staff.

The City of Toronto could set up a fraud/audit hotline with 24-hour voice mail, within the City Auditor's office. This hotline would be designated as a telephone resource for callers to report suspected incidents of fraud or other similar irregularities. Calls received would be screened by Audit staff and appropriately investigated in accordance with internal guidelines. Initial marketing and continued advertising of the hotline are important factors to its success and ongoing effectiveness.

In order to determine the feasibility and value of establishing a hotline to report suspected fraud in the City of Toronto, it would be appropriate to operate a hotline as a pilot project for a six-month period. This would allow the City Auditor's office to better identify the benefits, costs and issues associated with operating a hotline, before Council makes a permanent decision on this initiative.

While we will attempt to fund the pilot project within our 2002 funding request, there may be a need for additional funding if a significant number of calls are received that require investigation. My office will monitor the volume of calls received on an on-going basis and will advise Council if any additional funding for the pilot project is required.

The Chief Administrative Officer has been consulted in the preparation of this report.

Contact:

Tony Veneziano, Director, Audit Services, Tel: (416) 392-8353, Fax: (416) 392-3754
E-Mail: Tvenezia@city.toronto.on.ca

Carmelina Di Mondo, Project Manager, Tel: 416-397-7625, Fax: (416) 392-3754
E-Mail: cdimond@city.toronto.on.ca