OFFICE OF THE
City Auditor

Fraud Risk Management Review
March 18, 2010

THE CITY OF
Edmonton

The Office of the City Auditor conducted
this project in accordance with the
*International Standards for the
Professional Practice of Internal Auditing*

Fraud Risk Management Review

This page is intentionally blank.

Fraud Risk Management Review
Executive Summary

The Office of the City Auditor's (OCA) 2009 Annual Work Plan approved by City Council included a review of the City of Edmonton's Fraud Risk Management (FRM) Framework. The objectives of this review were to assess the City's current FRM Framework relative to leading practices, and based on the results of the assessment facilitate the preparation and prioritization of action plans for improving the City's FRM Framework.

To assess the City's current FRM Framework, we reviewed key documentation and facilitated two focus group sessions with representatives from Corporate Security, Labour Relations, Treasury Management, Materials Management, Risk Management and the Deputy City Manager's Office. We also researched leading FRM practices and conducted a high-level benchmarking study. For the purposes of this review, the term Fraud Risk Management is used to refer collectively to all policies, procedures and processes within the City that address issues related to fraud and misconduct.

City Council, through Audit Committee, is responsible for the governance oversight of fraud control and ensuring management accountability regarding audit matters. City Policy C522 – Fraud and Misconduct – Reporting, Investigation and Whistleblower Protection (Fraud Policy), Administrative Directive A1100C – Employee Code of Conduct (Code of Conduct Directive) and other related policies provide guidance on addressing fraud and misconduct in the City. In 2005, the City evaluated its ethics management framework in relation to leading practices. Based on the results of this evaluation, the City Auditor in conjunction with the General Manager of Corporate Services reviewed the need and assessed the risks and benefits of reporting alleged violations through a hotline. In 2006, the Fraud Policy was revised to provide employees whistleblower protection and in 2007, the City's Fraud and Misconduct Hotline was implemented as an additional channel for employees to confidentially and anonymously report suspected fraudulent activities and significant misconduct by City employees.

Our current review found that overall, the City's existing FRM Framework does include most of the fundamental elements of a FRM Framework. However, many of the elements can be further enhanced to minimize the City's risks and address potential fraud and misconduct. Based on the results of the assessment, we have prepared and prioritized three corporate action plans for improving the City's FRM Framework.

This is a multi-year program that will build on the City's existing practices to identify and mitigate fraud and risk exposures. Bylaw 15310 – *Audit Committee Bylaw,* passed on December 16, 2009 makes reference to the Committee's authority to review reports from the Administration respecting the City's processes and controls that prevent and detect fraud and misconduct. With a new City Manager and several new Senior Management staff, this is an opportune time to undertake and implement such a program. The OCA will work closely with the City Manager and Administration to initiate

these action plans and report on the progress towards identifying, assessing and managing the City's fraud and risk exposures.

The overall scope of the FRM program is based on a recent study sponsored by the Institute of Internal Auditors, the American Institute of Certified Public Accountants and the Association of Certified Fraud Examiners. It outlines five key principles for proactively establishing an effective FRM Framework: Fraud-risk governance, Fraud-risk assessment, Fraud prevention, Fraud detection and Fraud investigation and corrective action. Our current review focused on Principle 1 – Fraud-risk governance, which is the cornerstone for managing fraud risk.

The following are the 11 elements within Principle 1 that we used as the basis for our assessment and the overall results of our assessment:

FRM Principle 1 Elements	OCA's Assessment	Required Action
1. Roles and Responsibilities	Needs Improvement	Action Plan 1
2. Commitment to FRM	In Place	-
3. Fraud Awareness	Needs Improvement	Action Plan 2
4. Affirmation Process	In Place	-
5. Conflict of Interest	In Place	-
6. Fraud Risk Assessments	Needs Improvement	Action Plan 3
7. Reporting Procedures	Needs Improvement	Action Plan 1
8. Investigation Process	Needs Improvement	Action Plan 1
9. Corrective Action	In Place	-
10. Quality Assurance	Needs Improvement	Action Plan 3
11. Continuous Improvement	Needs Improvement	Action Plan 3

1. Fraud-Related Documents and Processes
Our review found that the definitions of fraud, misconduct and workplace issues constitute an overlap. The focus group participants indicated that they have an understanding of their respective roles and responsibilities, but lack clarity on the roles and responsibilities of others. Although there is a general awareness of the reporting process for allegations of fraud and misconduct, it may not be fully effective due to concerns about consistency in reporting, not reporting to the required entity, or reporting to multiple entities. Overall, FRM roles and responsibilities tend to overlap, contain inconsistencies and show gaps. There is a need for more effective communication between the Administration and the City Auditor to clearly understand and implement the corporate guidelines and implement a coordinated approach to address potential fraud and misconduct.

Action Plan 1
The OCA, in conjunction with the City Manager, will update the City's Fraud Policy and provide input in the update of the Code of Conduct Directive to provide further clarification and consistency on key areas such as definitions of fraud, misconduct, and workplace issues; roles and responsibilities; and reporting procedures. Any changes to the guidance documents and processes will be clearly communicated to all stakeholders.

2. Fraud Awareness
The City's overall commitment to FRM is clearly defined and documented in its Fraud Policy. A half day Code of Conduct training is mandatory for all City employees. Until November 2002, the City also offered Economic Crime Awareness Training. This training program is currently under review. Since the City's environment is constantly changing, periodic corporate reminders of FRM and the City's commitment to FRM are needed to keep the anti-fraud message fresh, and staff aware and fully informed.

Action Plan 2
The OCA, in conjunction with the City Manager, will establish and implement a corporate communication strategy to improve staff fraud awareness using a variety of tools and methodologies, including a fraud awareness training program that meets current and ongoing needs.

3. Fraud Risk Assessments
During our review, we found that the City does not currently have documented processes in place to conduct formal fraud risk assessments. Focus group participants agreed that the assessment of fraud risk is not systematic, but rather informal. Most internal controls, although they may exist, are not formally and directly linked to specific fraud risks. Further, the City's FRM Framework does not currently have formal processes in place to provide quality assurance, evaluate its effectiveness, and monitor the Framework to ensure its relevance on an ongoing basis.

The City has attempted to assess its risk through other frameworks such as the Corporate Business Risk Planning model that was rolled out in 2005. Our 2010 Annual Work Plan includes working with the Deputy City Manager's Office to further enhance the role of enterprise risk management. It is essential that the City's FRM model integrate with other related risk frameworks in order to provide a consistent approach for identifying and managing the City's risks.

Action Plan 3
The OCA, in conjunction with the City Manager, will focus on formalizing how Administration will periodically evaluate the City's fraud and misconduct risks and implement effective internal controls to minimize the City's risks. This will involve facilitating the development and implementation of a formal FRM template that includes processes for quality assurance, continuous monitoring, and integrating with other related risk frameworks.

Implementation of the above action plans will enable the City to enhance its FRM Framework, minimize its risks and provide assurance that steps are being taken by the Administration and the OCA to promote integrity and an ethical environment. It will also provide assurance that the City has adequately complied with the first principle of an effective FRM Framework and has plans in place to address the remaining four principles for proactively establishing an effective FRM Framework.

This page is intentionally blank.

Fraud Risk Management Review

1.   Introduction

The City of Edmonton (City) values integrity and ethics, and expects its employees to demonstrate civic values by working responsibly, being trustworthy and behaving ethically. However, the risk of occupational fraud and misconduct is an inherent part of conducting business in all organizations, including the government sector. Only through diligent and ongoing effort can an organization protect itself against significant acts of fraud. The Office of the City Auditor's (OCA) 2009 Annual Work Plan approved by City Council included a review of the City's Fraud Risk Management Framework.

2.   Background

Fraud negatively impacts organizations in many ways including financial, reputational, psychological and social implications. According to the Association of Certified Fraud Examiners (ACFE) *Detecting Occupational Fraud in Canada* (2007)*,* the typical Canadian organization loses 5% of its annual revenues to fraud every year. However, the full cost of fraud is immeasurable as it also includes loss of time, productivity, and citizens' confidence in the organization. Therefore, it is important to have a strong and effective Fraud Risk Management (FRM) Framework in place. For the purposes of this review, FRM is used to refer collectively to all policies, procedures and processes within the City that address issues related to fraud and misconduct.

Establishing and maintaining a strong environment to effectively manage fraud risks is an ongoing process. It starts with having an appropriate governance structure in place to manage occupational fraud. Promoting a corporate culture with a clear understanding of the corporation's expectation of employee behaviour, as well as enhancing progress towards meeting those expectations, results in an environment that builds public trust and confidence.

City Policy C522 – Fraud and Misconduct – Reporting, Investigation and Whistleblower Protection (Fraud Policy), Administrative Directive A1100C – Employee Code of Conduct (Code of Conduct Directive) and other related policies provide guidance on addressing fraud and misconduct in the City. In 2005, the City evaluated its ethics management framework in relation to leading practices. Based on the results of this evaluation, the City Auditor in conjunction with the General Manager of Corporate Services reviewed the need and assessed the risks and benefits of reporting alleged violations through a hotline. In 2006, Council approved revisions to the Fraud Policy including the provision of whistleblower protection for employees and the implementation of a Fraud and Misconduct Hotline. In 2007, the City implemented its Hotline as an additional channel for employees to confidentially and anonymously report suspected fraudulent activities and significant misconduct by City employees.

The following fraud-related policies and directives form the basis of the City's FRM Framework:

City Policy C522 – Fraud and Misconduct – Reporting, Investigation and Whistleblower Protection (Fraud Policy)

In June 2006, City Council approved the Fraud Policy. This policy establishes *"an integrated framework that provides guidance to enhance existing City policies and administrative directives that address issues related to reporting and investigating alleged fraud and misconduct"*. The policy demonstrates that the City *"is committed to the principles of corporate accountability, transparency, responsibility, and sound ethical operating practices".*

Administrative Directive A1100C – Employee Code of Conduct (Code of Conduct Directive)

The existing Code of Conduct Directive came into effect in June 2002. It establishes "*principles for appropriate conduct in the work place by Employees in the discharge of their duties."* The directive requires City employees to follow eight principles pertaining to appearances before Council, city assets, disclosure of information, gifts and gratuities, other employment, personal conduct, personal gain or benefit, and political activity. It also defines roles and responsibilities of employees, supervisors, General Managers, the City Manager and the City Auditor.

Other fraud-related documents

There are other bylaws, policies and procedures within the City that manage fraud risks, including but not limited to:

- Audit Committee Bylaw 15310 (2009)
- City Auditor Bylaw 12424 (2006) and City Administration Bylaw 12005 (2009)
- Administrative Directive A1102 – *Discipline of City Employees* (1986) and Staff Discipline Manual (1991) (currently being updated)
- Administrative Directive A1200B – *Handling of City Money* (2007) and Handling of City Money Handbook (2007)
- Administrative Directive A1203B – *City Employees, Contracts With The City* (2006)
- Risk Management Manual (2004) and Corporate Security Investigation Protocol (2007)
- Protocol for Investigations of Fraud and Misconduct Reports (2007)

In addition, a number of external policies and agreements influence and regulate the behaviour of City staff, including but not limited to collective agreements and code of ethics of various professional associations.

3.   Objectives, Scope and Methodology

Review objectives
The objectives of this review were to:

1. Assess the City's current FRM Framework relative to leading practices, and
2. Based on the results of the assessment, facilitate the preparation and prioritization of action plans for improving the City's FRM Framework.

Scope and methodology
This project is part of a multi-year program aimed at identifying, assessing, and managing the City's fraud exposure. The overall scope of the program is based on a recent study sponsored by the Institute of Internal Auditors, the American Institute of Certified Public Accountants and the ACFE, which outlines five key principles for proactively establishing an effective FRM Framework[1]:

Principle 1: Fraud-risk governance – As part of an organization's governance structure, a FRM Framework should be in place, including a written policy (or policies) to convey the expectations of the board of directors and senior management regarding managing fraud risk.

Principle 2: Fraud-risk assessment – The organization should periodically assess fraud risk exposure to identify specific potential schemes and events that the organization needs to mitigate.

Principle 3: Fraud prevention – The organization should establish prevention techniques, where feasible, to avoid potential key fraud risk events and to mitigate possible impacts on the organization.

Principle 4: Fraud detection – The organization should establish detection techniques to uncover fraud events when preventive measures fail or unmitigated risks are realized.

Principle 5: Fraud investigation and corrective action – The organization should construct a reporting process to solicit input on potential fraud, and use a coordinated approach to investigation and corrective action to help ensure potential fraud is addressed appropriately and timely.

Adopting and implementing these principles over time by building on the already existing elements will help ensure that there is suitable oversight of FRM in the City; that fraud exposures are identified and evaluated; that appropriate processes and procedures are in place to manage those exposures; and that fraud allegations are addressed in an appropriate and timely manner. Appendix A identifies key elements for each of the five principles.

---

[1] Institute of Internal Auditors, the American Institute of Certified Public Accountants, Association of Certified Fraud Examiners, *Managing the Business Risk of Fraud: A Practical Guide* (2009).

In this first phase of the review, we focused on assessing the City's FRM Framework relative to Principle 1 in particular and Principles 2 to 5 in general. There are 11 elements within Principle 1 - Fraud-risk Governance. For each of the 11 elements we identified who is responsible for the task, how is it implemented and in what format the element exists in the City (e.g. City policy, Directive, or manual).

To gather information on the City's FRM Framework we reviewed key documentation and facilitated two focus group sessions with representatives from Corporate Security, Labour Relations, Treasury Management, Materials Management, Risk Management and the Deputy City Manager's Office. We also researched leading FRM practices and conducted a high-level benchmarking study. The benchmark cities included Toronto, Calgary, Hamilton, Ottawa and Winnipeg.

The following are the 11 elements within Principle 1 that we used as the basis for our assessment:
1.   Roles and Responsibilities
2.   Commitment to FRM
3.   Fraud Awareness
4.   Affirmation Process
5.   Conflict of Interest
6.   Fraud Risk Assessments
7.   Reporting Procedures
8.   Investigation Process
9.   Corrective Action
10.   Quality Assurance
11.   Continuous Monitoring

# 4.   Summary of Results

4.1.   Definitions of Fraud, Misconduct and Workplace Issues

The City's Fraud Policy distinguishes between fraud, misconduct, and workplace issues in the following manner:

- **Fraud:** "*in accordance with the Criminal Code of Canada, is an act committed by one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of the Criminal Code of Canada, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service.*"

- **Misconduct** "*includes unethical behaviour, wilful omission to perform one's duties, abuse of authority, theft, embezzlement, receipt of bribes, kickbacks or gifts of significant value, breach of federal, provincial or municipal legislation and significant waste of City assets*".

- **Workplace issues** "*include performance issues, performance management process concerns, unfair treatment and harassment.*" The policy clearly states that workplace

issues should not be reported under the fraud policy, but dealt with in accordance with applicable City Policies and Administrative Directives (e.g. Administrative Directive A1127 - Respectful Workplace.)

The above definitions constitute an overlap as illustrated in figure 1 below.

Figure 1: Fraud, Misconduct and Workplace issues
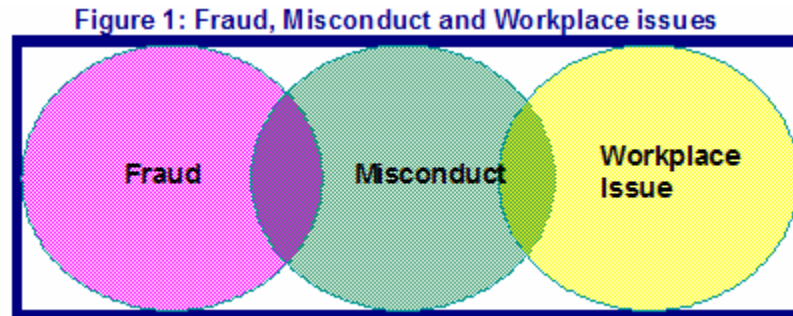
The following examples illustrate the overlap in the definitions:
- Theft of a City owned laptop by an employee: Based on the definitions this could be interpreted as fraud and/or misconduct. Fraud because the employee is defrauding the City of an asset through larceny[2], and misconduct because theft is specifically mentioned in the definition of misconduct.
- Harassment of an employee by a supervisor: Based on the definitions this could be interpreted as misconduct (abuse of authority) and/or a workplace issue. It also falls under the Personal Conduct principle of the Code of Conduct and the Administrative Directive A1127 *Respectful Workplace.*
- Inappropriate overtime reporting by an employee: Based on the definitions this could be interpreted as both fraud and misconduct. Fraud because by deceit the employee is defrauding the City of money through a payroll scheme, and misconduct because it portrays both unethical behaviour and indirect theft. Since the situation involves a supervisor and an employee it can also be considered a workplace issue.

How an incident is initially defined will determine how the allegation is reported to other levels of Administration or outside of Administration (OCA or EPS) and who will conduct what type of investigation. It is therefore essential to provide additional clarification and consistency in the definition of fraud, misconduct and workplace issues. **(Action Plan 1)**

4.2.   Assessment of the 11 Elements (Principle 1)

The following sections describe the current state of the 11 elements of the City's FRM Framework based on the results of our documentation review and focus group sessions, and the resulting action plans:

---

[2] Larceny is the legal term for stealing. Obtaining possession of property by fraud, trick or device with preconceived design or intent to appropriate, convert, or steal is larceny. For our purposes, larceny is the most basic type of inventory theft, in which an employee simply takes inventory from the company premises without attempting to conceal it in the books and/or records.

4.2.1.   Roles and Responsibilities

To help ensure the effectiveness of an organization's FRM Framework, it is important to clarify the roles and responsibilities that personnel at all levels of the organization have with respect to FRM. Based on the various policies and directives, including but not limited to the Fraud Policy, the Code of Conduct Directive and the City Auditor Bylaw, the following is a high-level description of the roles and responsibilities of each of the key groups:

- **City Council** leads the City's FRM Framework. It governs the corporation by setting policy (including the Fraud Policy) and defining the corporate strategic direction, as well as directing the City Manager. City Council, through **Audit Committee**, is also responsible for the governance oversight of fraud control and ensuring management accountability regarding audit matters.

- **The City Manager and Senior Management Team** carries out Council's direction and administers public services. This includes designing and implementing a fraud prevention strategy and, in regards to their respective departments, making decisions regarding FRM activities and initiatives. The City Manager is also responsible for approving fraud-related directives (e.g. Code of Conduct and Discipline Directives) and investigating allegations of misconduct, retaliation and workplace issues.

- **Management** (General Managers, Branch Managers, Directors) are responsible for establishing and maintaining a system of internal control to provide reasonable assurance of the efficiency of their operations, including the prevention and detection of fraud and misconduct. Management has to exercise due diligence to prevent, detect and report fraud, misconduct and retaliation, which includes recognizing "red flags" that may indicate fraud and reporting alleged incidents.

- All **City employees** are required to comply with City policies and directives. In addition, employees are required to report suspicions or incidences of fraud and misconduct they witness, and cooperate in all investigations.

In their effort to prevent fraud, Management is supported by the following specialized entities:

- **The City Auditor** is responsible for reviewing, assessing and reporting on the adequacy of controls in place to safeguard the City's assets against fraud and misconduct. Specific roles in relation to FRM include initial or full investigation of suspected fraud and significant misconduct; root cause analysis and providing recommendations on improving internal controls; administering the City's Fraud and Misconduct Hotline (Hotline); recommend changes to the Fraud Policy; and reporting of investigation results and Hotline activities to the Audit Committee.

- **Law Branch** (Corporate Security) investigates security breaches, designs security systems (including but not limited to card access and video surveillance), and conducts physical security audits. Corporate Security also assists the Administration and the City Auditor with investigations regarding alleged fraud and misconduct. The

- **Human Resources Branch** (Labour Relations) monitors the consistent administration of the Discipline Policy by departments and provides assistance and advice to departments concerning appropriate disciplinary actions. In addition, Labour Relations provides advice to management on a wide range of employee issues including but not limited to performance and attendance management, and ensures appropriate processes with respect to employee's benefits, rights, and well-being are followed during investigations.

In general, fraud and misconduct activities are assigned to those who have the appropriate expertise. However, general internal control and anti-fraud initiatives are embedded in department activities and resourced accordingly.

The focus group participants indicated that they have an understanding of their respective roles and responsibilities, but lack clarity on the roles and responsibilities of others. Furthermore, what participants perceived to be their roles and responsibilities may not be consistent with what is documented in various policies and directives. In particular, there is confusion about how investigations are conducted and by whom. Overall, FRM roles and responsibilities tend to overlap, contain inconsistencies and show gaps. The Fraud Policy and the Code of Conduct Directive need to be reviewed and updated as required to ensure further clarification and consistency of the roles and responsibilities regarding FRM. In addition, the clarified roles and responsibilities need to be clearly communicated to the various stakeholders. **(Action Plan 1)**

4.2.2.   Commitment to FRM
The foundation of any FRM Framework is the clear commitment of an organization to mitigating fraud risk. This commitment should be documented in a policy and embedded in the organization's values. The City's commitment to FRM is clearly defined and documented in its Fraud Policy. Focus group participants agreed that the City's commitment is clearly documented, but communications need to be improved as employees may not have a full understanding of the City's commitment to FRM. No immediate action plans have been identified regarding the City's FRM commitment. The required action plan to improve communications and awareness will be addressed under section 4.2.3. – *Fraud Awareness.*

4.2.3.   Fraud Awareness
Promoting staff awareness of fraud prevention, detection and reporting is an integral part of creating an effective and efficient anti-fraud culture and fostering a culture of compliance. Staff needs to be kept informed about the organization's commitment to mitigating fraud and what part they are expected to play in the FRM Framework (such as immediate reporting of suspected fraud or misconduct). The following is our assessment in relation to leading practices for promoting fraud awareness:

- **Periodic assessment of fraud awareness –** The City's evaluation of its ethics management framework (2005) in relation to leading practices was a key step in

assessing the City's fraud awareness. Based on the results of this evaluation, the City Auditor in conjunction with the General Manager of Corporate Services reviewed the need for reporting alleged violations through a hotline and undertook a survey of City employees to gauge employee perceptions. This current review can also be considered as a preliminary step towards assessing fraud awareness.

- **Training -** Awareness of key FRM-related policies and directives is created at the Code of Conduct Training session that is mandatory for new employees. Until November 2002, the City also offered Economic Crime Awareness Training. This training program is currently under review. Over the past few years, Corporate Security has developed a number of training and awareness programs aimed at mitigating risk exposures and strengthening specific controls (e.g. robbery prevention and office security). Additionally, the Risk Management Section works with Departments when a risk exposure has been identified or when a loss has occurred.

- **Frequent Communication-** Initial communication of the City's expectations took place during roll out of the various fraud-related policies and directives. In addition, the City Auditor in collaboration with the City Manager regularly reviews the need for ongoing communication on the Fraud and Misconduct Hotline at various milestones.

- **Other-** The City also uses some other techniques to foster fraud awareness:
  - o All policies and directives are available internally on e-City, however related protocols and manuals are not consistently available.
  - o eCity WebPages outline information on the Hotline and Code of Conduct.
  - o The Hotline contact information is published on the annual payroll calendar.
  - o Compliance to the Code of Conduct is included in management's annual performance reviews (one of seven core values – Integrity and Ethics).

According to the focus group, employees have a general awareness of reporting issues to their supervisors or using the Hotline. However, the focus group was divided on whether staff is kept informed about the City's commitment to FRM. Since employees deal with a lot of information on a variety of topics, periodic corporate reminders of FRM and the City's commitment to FRM are needed to keep the anti-fraud message fresh, and staff aware and fully informed. **(Action Plan 2)**

4.2.4.   Affirmation Process

According to leading practices an organization should have an affirmation process, which is the requirement for directors, employees, and contractors to acknowledge that they have read, understood and are in compliance with the code of conduct, the fraud control policy and other such documentation to support the organisation's FRM Framework. The City's Fraud-related policies and directives are accessible to all employees through the Code of Conduct training and through the City's website. In addition, the City has an affirmation process for the Code of Conduct. Each new employee is required to sign an Acknowledgement Form that states that he/she has received the Code of Conduct Directive and the Code of Conduct Handbook. In addition, the Directive states that Employees are responsible for "*Reading and*

complying with the Code of Conduct." Based on the City's current environment and other compensating controls, we have not identified any formal action plans.

4.2.5.   Conflict of Interest

Organizations should have a process in place for employees to internally self-disclose potential or actual conflicts of interest. The City's Code of Conduct Directive and Administrative Directive A1203B *City Employees – Contracts With the City* both deal with disclosing conflict of interest. The current City process is consistent with leading practices and other benchmark cities. As a result, we have not identified any action plans.

4.2.6.   Fraud Risk Assessments

Leading practices state that "*A fraud risk assessment should be performed on a systematic and recurring basis, involve appropriate personnel, consider relevant fraud schemes and scenarios, and mapping those fraud schemes and scenarios to mitigating controls".* Fraud Risk Assessment is also the second principle for proactively establishing an environment to effectively manage an organization's fraud risk. Figure 2 provides an overview of a fraud risk assessment process.

Figure 2: Fraud Risk Assessment Process
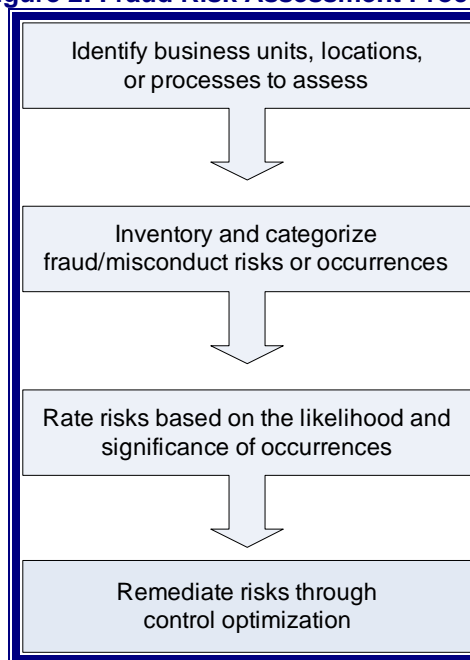
Source: KPMG Forensic, *Fraud Risk Management* (2006)

The Fraud Policy states that *"General Managers or his/her designates are responsible for establishing and maintaining a system of internal control to provide reasonable assurance of the efficiency of their operations, including the prevention and detection of fraud and misconduct. Management should be familiar with the types of fraud and misconduct that might occur within their area of responsibility and be alert for any indicators of such conduct".* In addition, as required by Section 5135 of the of the

Canadian Institute of Chartered Accountants (CICA) Handbook, the External Auditor reviews management's assessment of fraud risks and considers management's responses when completing the risk assessment for purposes of their financial statement audit planning and reporting.

However, the City currently does not have documented processes in place to conduct fraud risk assessments at any level (e.g. corporate-wide, business unit, significant account levels, special areas or circumstances). Focus group participants agreed that assessments of fraud risk is not systematic, but rather informal. In addition, most internal controls, although they may exist, are not formally and directly linked to specific fraud risks. The City needs to establish and implement a formal FRM template that focuses on formalizing how Administration will periodically evaluate the City's fraud and misconduct risks and implement effective internal controls to minimize the City's risks. **(Action Plan 3)**

The City has attempted to assess its risks through other frameworks such as the Corporate Business Risk Planning model that was rolled out in 2005. Our 2010 Annual Work Plan includes working with the Deputy City Manager's Office to further enhance the role of enterprise risk management. It is essential that the City's FRM model integrate with related frameworks in order to ensure a consistent approach for identifying and mitigating the City's risks. **(Action Plan 3)**

4.2.7. Reporting Procedures

The channels to report suspected fraud and misconduct issues should be clearly defined and communicated throughout the organization. In its 2007 Report on *Detection of Occupational Fraud in Canada,* the Association of Certified Fraud Examiners (ACFE) found that tips are the number one method of detecting fraud.

The City has processes and documentation in place to communicate its expectation that City employees should report suspected fraud immediately and that whistleblower protection will be provided. The current whistleblower process is consistent with benchmark cities and leading practices. Employees have several avenues available to report suspected fraud, misconduct, workplace issues and/or violations of the Code of Conduct. Employees can report their complaints to their Supervisor, General Manager, City Manager, City Auditor or other City resources, such as Corporate Security, their Human Resources Business Partner or the City Chaplain. Employees can also use the City's hotline.

For reports received through the Hotline there is a clear process described in the *Protocol for Investigation of Fraud and Misconduct Reports.* For misconduct, the Code of Conduct Directive defines the following reporting steps:
- Supervisors, Directors, Branch Managers receiving allegations of Code violations are to inform their supervisor or General Manager, City Manager or City Auditor,
- General Managers are to advise City Manager of any significant alleged Code violations,
- City Auditor and City Manager exchange receipt of alleged Code violations.

Focus group participants indicated that even though they are aware of this reporting process it may not be fully effective due to concerns about inconsistency in reporting, not reporting to the required entity or reporting to multiple entities. The result is that suspected allegations may not be investigated properly (or at all). For example a receiving entity may determine there is not enough information to conduct an investigation; because other related reports made to other entities are not linked. Alternatively, if there is more than one receiving entity, the same allegation could be investigated twice, resulting in duplication of efforts. The City needs to review and revise the reporting procedures included in the Fraud Policy and the Code of Conduct to ensure reported allegations and complaints are dealt with in an appropriate, consistent and efficient manner. **(Action Plan 1)**

4.2.8.   Investigation Process

Organizations should have an investigation process in place. Based on leading practices, the most common features of an effective investigation process include:

- A policy requirement to fully investigate any suspected acts of fraud, theft, misappropriation or other related irregularities.
- Oversight by the organization's audit committee.
- Clear roles and responsibilities of management and investigating staff.
- Well-defined investigation guidelines which includes the following steps:
    - o Determining the scope and nature of any investigation
    - o Conducting the investigation
    - o Gathering the evidence
    - o Concluding the investigation and reporting on results
- A confidentiality requirement. Investigation details and results are to be kept confidential and will not be disclosed or discussed with anyone other then those who have a legitimate need to know.
- A full cooperation requirement, allowing no employee or member of management to obscure the facts that gave rise to the investigation.
- Access to well-trained and experienced investigators.
- Referral of complaints to other administrative processes whenever appropriate.

According to the Fraud Policy, the City Manager is responsible for investigating allegations of workplace issues, misconduct and retaliation. The City Auditor is responsible for investigating allegations of fraud and significant misconduct. A Protocol Document prepared and maintained by the City Manager and the City Auditor is in place that outlines who will investigate complaints received from employees and how referrals to other City resources will take place depending on the nature of the complaint. Both the City Auditor and City Manager are responsible for ensuring that investigations under their responsibility are conducted by a qualified team, utilizing internal resources as much as possible.

As indicated under Section 4.2.7. – *Reporting Procedures*, focus group participants have indicated their concerns about consistency in reporting, not reporting to the required entity or reporting to multiple entities. This may have an impact on how the

reported complaints are investigated. The Fraud Policy and the Code of Conduct Directive need to be reviewed and updated with a view to providing clarification on the definitions of fraud, misconduct and work place issues, roles and responsibilities and reporting procedures. **(Action Plan 1)**

4.2.9. Corrective Action

A consistent and credible disciplinary system is a key control that can be effective in deterring fraud and misconduct. By mandating meaningful sanctions, management can demonstrate to both internal and external parties that the organisation considers managing fraud and misconduct risk a top priority.

The City has corrective action policies in place including consequences and processes for those who commit or condone fraudulent activities. The Staff Discipline Manual is consistent with leading practices in that it includes company-wide guidelines that promote progressive sanctions and uniform and consistent application of discipline regardless of rank, tenure, or job function. Furthermore, the Fraud Policy includes sections on civil action, criminal referral and insurance claims. No immediate action plans have been identified as processes are in place for all types of corrective action.

4.2.10. Quality Assurance

Organizations should formally outline whether, and/or how, the effectiveness of the FRM Framework will be evaluated. The results of this evaluation should be reported to appropriate oversight groups and used to improve the FRM Framework. Council, through the Audit Committee, has oversight responsibilities for management's efforts to create a strong internal control environment, including the design and implementation of anti-fraud programs. Council's oversight of FRM is essential to ensure management has exercised due diligence to mitigate risk and exposures from wrongdoing. Oversight is accomplished through continuous monitoring and quality assurance processes.

In accordance with City Auditor Bylaw 12424, the City Auditor currently provides the Audit Committee with oversight information through its annual report on hotline activities and briefings on individual cases that are likely to have a significant impact on the organisation. The Code of Conduct Directive includes requirements for quarterly reporting by City Administration on the status and results of investigations of Code of Conduct violations. However, no formal quarterly reporting is currently in place, although informal reporting on individual incidents does take place.

In addition, Corporate Security compiles a monthly statistical report on security incidents. This report does not contain information on disposition of reported incidents or outcomes of investigations. The separate reporting mechanisms of the City Manager and the City Auditor may provide challenges in tracking of measurements for quality assurance purposes and analysis of statistics to identify systemic or corporate issues for further investigation. The City needs to develop and implement a formal quality assurance process within its FRM Framework that evaluates and reports its overall effectiveness, and identifies process improvements that can be implemented to manage the City's fraud and risk exposures. Based on the results, a formal FRM template will be

prepared in conjunction with the City Manager and the Administration for roll out to other business units. **(Action Plan 3)**

4.2.11. Continuous Monitoring

The FRM Framework, including related documentation, should be revised and reviewed on an ongoing basis to reflect the organization's continuing commitment to FRM and the changing needs of the organization.

The City has a number of related resources (policies, procedures, administrative directives, bylaws, and protocols) to support and enhance FRM. Our review indicated that a number of these documents need to be reviewed and updated to ensure consistency and relevance. For instance, the Code of Conduct was scheduled for a review in 2007. This review has not been undertaken to date. In contrast, City Administration is currently in the process of updating Administrative Directive A1102 *Discipline of City Employees* and the Staff Discipline Manual. Both documents have not been revised for about 20 years. The City should aim at reviewing and revising as many FRM-related documents as possible, as part of a comprehensive FRM Framework and not as stand-alone documents. **(Action Plans 1 and 3)**

5.   Conclusion and Action Plans

Our objectives were to assess the City's current FRM Framework relative to leading practices, and based on the results of the assessment; facilitate the preparation and prioritization of action plans for improving the City's FRM Framework.

Our review shows that the City's current FRM Framework does include most of the fundamental elements of a FRM Framework. However, many of the elements can be further enhanced to minimize the City's risks. Some of the FRM-related policies, directives, and manuals need to be updated and better communicated to employees and management. In addition, to strengthen the City's environment and effectively manage fraud risk, FRM elements such as roles and responsibilities, fraud risk assessments, reporting procedures, investigation process, quality assurance and continuous monitoring need to be enhanced further.

Based on the results of the assessment, we have prepared and prioritized three corporate action plans for improving the City's FRM Framework. This is a multi-year program that will build on the City's existing practices to identify and mitigate fraud and risk exposures. Bylaw 15310 – Audit Committee Bylaw*,* passed on December 16, 2009 makes reference to the Committee's authority to review reports from the Administration respecting the City's processes and controls that prevent and detect fraud and misconduct. With a new City Manager and several new Senior Management staff, this is an opportune time to undertake and implement such a program. The OCA will work closely with the City Manager and Administration to initiate these action plans and report on the progress towards identifying, assessing and managing the City's fraud and risk exposures. Timelines for implementation will be worked out with the City Manager.

The following are the action plans with their recommended priority for implementation:

Action Plans	Priority
1: FRM-related Documents	
The OCA, in conjunction with the City Manager, will update the City's Fraud Policy and provide input in the update of the Code of Conduct Directive to provide further clarification and consistency on key points such as definitions of fraud, misconduct, and workplace issues; roles and responsibilities; and reporting procedures. Any changes to the guidance documents and processes will be clearly communicated to all stakeholders.	1
2: Fraud Awareness	
The OCA, in conjunction with the City Manager, will establish and implement a corporate communication strategy to improve staff fraud awareness using a variety of tools and methodologies, including a fraud awareness training program that meets current and ongoing needs.	2
3: Fraud Risk Assessment	
The OCA, in conjunction with the City Manager, will focus on formalizing how Administration will periodically evaluate the City's fraud and misconduct risks and implement effective internal controls to minimize the City's risks. This will involve facilitating the development and implementation of a formal FRM template that includes processes for quality assurance, continuous monitoring, and integrating with other related risk frameworks.	3

Implementation of the above action plans will enable the City to enhance its FRM Framework, minimize its risks and provide assurance that steps are being taken by the Administration and the OCA to promote integrity and an ethical environment. It will also provide assurance that the City has adequately complied with the first principle of an effective FRM Framework and has plans in place to address the remaining four principles for proactively establishing an effective FRM Framework.

We would like to thank all City staff who participated in this review for their cooperation and assistance.

Appendix A

Fraud Risk Management Framework

Principle 1	Principle 2	Principle 3	Principle 4	Principle 5
FRM Framework	Periodic Fraud Risk Assessment	Fraud Prevention Techniques	Fraud Detection Techniques	Fraud Investigation and Corrective Action
Elements of anti-fraud policy/program: o Roles and responsibilities o Commitment o Fraud awareness o Affirmation process o Conflict disclosure o Fraud risk assessment o Reporting procedures and whistleblower protection o Investigation process o Corrective action o Quality assurance o Continuous monitoring	Types of fraud risk assessment: o Corporate-wide o Business unit o Significant account levels o Special areas or circumstances Elements of fraud risk assessment: o Identify business units, locations or processes o Identify inherent fraud risk o Assess likelihood and significance of inherent fraud risk o Respond to reasonably likely and significant inherent and residual fraud risk	Example elements in fraud prevention: o Code of Conduct o HR-procedures (background checks, exit interviews) o Anti-fraud training o Evaluating performance and compensation programs o Authority limits o Transaction-level procedures (review of third- or related party transactions) o Fraud awareness	Example elements in fraud detection: o Hotlines and whistleblower mechanisms o Process controls (reconciliations, reviews, physical inspections/counts, audits, analyses) o Proactive fraud detection (data analysis, ACL)	Example elements in fraud investigation and corrective action: o Internal investigation protocols o Disciplinary system o Corrective action o Disclosure protocols

Source: Institute of Internal Auditors, The American Institute of Certified Public Accountants, Association of Certified Fraud Examiners, *Managing the Business Risk of Fraud: A Practical Guide* (2009).