

**GOVERNMENT EMPLOYEE FRAUD:  
A MODEL REPORTING FRAMEWORK AND A SURVEY OF  
CURRENT PRACTICES IN CANADA, THE UNITED STATES AND  
OTHER JURISDICTIONS**

**Research Project for Emerging Issues/Advance Topics Course  
Diploma in Investigative and Forensic Accounting Program**

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**June 13, 2005**

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## **1.0 Executive Summary**

The Association of Certified Management Accountants estimates that a typical organization loses approximately 6% of its revenues due to fraud committed by its employees. Governments have budgets of millions and billions of dollars and employ a large number of individuals, and as such, the potential for losses due to fraud by government employees is very high. Governments should strive to create an environment where employees are aware of the repercussions of fraud and the non-reporting of fraud. This environment will consist of many factors including an effective internal audit function; deterrence through proper internal controls; educational efforts about fraud indicators and an effective fraud-reporting framework. This fraud-reporting framework should include the following seven components:

1. A requirement to report;
2. A mechanism to facilitate reporting;
3. Disciplinary measures for non-reporting;
4. Protection from retaliation;
5. Investigation methodology
6. Prosecution/Recovery
7. Public Reporting

The findings related to each of these components are summarized below.

### **1.1 Requirement to Report**

Nine Canadian governments and fourteen U.S. state governments require the reporting of fraud by employees. The Canadian requirements are in the form of

internal policies, while the U.S. requirements are legislated. These policies would be considered effective if they meet the criteria of deterrent, detective and educational.

### 1.2 Mechanism to Facilitate Reporting

Twenty-nine U.S. state governments have implemented a hotline for the confidential reporting of fraud by employees and the general public. There are no hotlines implemented in Canadian governments.

### 1.3 Disciplinary Measures for Non-reporting

Governments have not been aggressive in mandating disciplinary measures for failing to comply with the reporting requirements. Two U.S. states currently have legislated disciplinary measures for the non-reporting of known cases of fraud. This topic is not covered by any of the policies in effect in Canada.

### 1.4 Protection from Retaliation

Whistleblowing legislation typically provides the protection from retaliation. U.S. state governments have been very forthcoming with this legislation with 40 states currently having whistleblowing legislation in effect. In Canada, only Nova Scotia has implemented this legislation.

### 1.5 Investigation Methodology

Although nine provincial governments require the reporting of incidents of fraud, only two require that these incidents be reported to the province's independent,

investigative body, which is usually the Auditor General. Many state governments are aggressive in the investigation of incidents of fraud and theft. An excellent example is the State of Mississippi. The Mississippi State Auditor's Office reports annually on the status of its state employee fraud investigations.

#### 1.6 Prosecution/Recovery

Canadian governments tend to be passive when it comes to the prosecution of employee theft and fraud and the recovery of public funds lost due to these incidents. Although Canadian information was received with respect to incidents forwarded to prosecution, there was also information provided as to large frauds where no attempt was made to prosecute. Conversely, U.S. governments tend to be more aggressive in the prosecution of fraud cases and more diligent in the recovery of these misappropriated funds.

#### 1.7 Public Reporting

Governments that report loss information to the public do so at varying levels of detail. A few U.S. state governments have very detailed reports that give the specifics of the incident, the name of the person committing the crime and the resolution of the case. Other state governments provide only summary information, and still other state governments provide no information at all. Provincial governments in Canada also typically provide no information at all. The Government of Canada reports these losses annually, but not in great detail.

It is clear, from the multitudes of information obtained, that some governments are better than others with respect to implementing each component of the model framework. The benefits of this reporting system are discussed in Section 2.0 of this paper.

Governments should learn from each other and implement a model that is both effective, efficient and is tailored to each specific government's needs. The framework presented in this paper has been developed from the practices that are currently in place in governments of various jurisdictions.

## **2.0 Objective**

Many governments have higher revenues and more employees than many of the world's largest corporations. Therefore, it is of utmost importance that governments realize the risk to public money from employee fraud and theft and create an appropriate environment to address these risks.

The objective of this paper is to present and discuss a model reporting framework to be implemented by governments with respect to losses of public monies as a result of illegal acts by public servants. The goal of these models is to:

- enhance detection of these crimes;
- deter employees from committing these crimes;
- educate employees about the implications of fraud and measures to prevent and detect fraud
- promote accountability of government departments and agencies; and
- promote transparency.

It will be clear from the analysis, that while some governments have excellent frameworks in place, many governments do not have adequate policies and procedures in place to address the area of employee fraud.

A secondary objective is to show how an effective fraud detection and prevention strategy can help ensure that frauds in the government workplace are minimized. This paper will also attempt to provide insight as to how having an Investigative and

Forensic Accountant (IFA) employed can be beneficial to government departments and agencies.

### **3.0 Documents Reviewed and Relied Upon**

In addition to the documents listed in the bibliography, several sources were reviewed for this paper. Provincial Governments provided documents either through a request for information under the respective Province's Freedom of Information and Protection of Privacy Act or through my employment position. The information provided here contains details of all losses reported in the respective Province over the last 5 years.

For all of the State, Provincial and Federal governments, the main websites were reviewed as well as the websites for the State and Provincial Auditors. Information on policies and legislation in effect in each of these jurisdictions can be gleaned from the government sites. The Auditor's sites often contain reports of investigations with respect to fraud against the government.

Telephone discussions were held with many jurisdictions, including an in depth discussion with a forensic accountant with the State of New York Office of the Inspector General and the Director of Investigations for the Mississippi State Auditor. An interview was also conducted with a CFE from the University of Colorado who is writing a book on government employee fraud.

## 4.0 Background

For the purposes of this paper, a loss of public monies due to illegal acts by employees concentrates on the crimes of fraud and theft. Occasionally, when governments use similar terms such as embezzlement or conversion, those terms have been used in this paper. Unless otherwise indicated, fraud and theft by employees relates to public monies that have been misappropriated through these illegal acts by individuals employed by the government department or agency having custody or the rightful ownership to the monies.

Losses due to illegal acts such as fraud and theft by employees affect all organizations from small owner managed businesses to large multinational corporations.

Government departments and agencies are no exception. In fact, due to the decentralization of many governments, and the millions, billions or even trillions of dollars in their annual budgets, it may be argued that governments are more susceptible to losses due to an employee's illegal acts, especially considering the large number of individuals that are employed by governments. Statistics for the State of California indicate that there were 468,200 state government employees at April 30, 2005<sup>1</sup>. To contrast, the website for General Motors indicates that it employs approximately 321,000 people worldwide<sup>2</sup>, and General Electric employs approximately 300,000<sup>3</sup>.

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<sup>1</sup> California LaborMarketInfo, Data Library, report generated from <http://www.labormarketinfo.edd.ca.gov/cgi/dataanalysis/> on May 21, 2005

<sup>2</sup> GM Company Information accessed from [http://www.gm.com/company/corp\\_info/](http://www.gm.com/company/corp_info/) on May 23, 2005.

The Association of Certified Fraud Examiners (ACFE) “Report to the Nation on Occupational Fraud and Abuse” estimates that a “typical organization loses 6% of its annual revenues due to occupational fraud”<sup>4</sup>. This figure when multiplied by the total revenues of the Canadian government for 2004 of \$198.5 Billion<sup>5</sup> amounts to a potential loss of \$11.9 Billion due to fraud. Although the actual reported Canadian figure for losses due to illegal acts does not approach this figure, (see Section 7.1) the potential impact is eye opening. The report of the ACFE also provides that the most common type of fraud in government organizations is a result of billing schemes, where the government organization pays more for goods or services due to improper (fraudulent) billing by vendors. This type of fraud is outside of the scope of this paper as vendors are not employees. The next two most common types of fraud in government organizations is skimming (22.7% of all government fraud cases<sup>6</sup>) and cash larceny (18.7%<sup>7</sup>). Skimming is defined as stealing money from an organization before the funds are recorded in the books of account. Cash larceny is stealing from an organization after the funds have been recorded in the books of account. The survey that was undertaken by the ACFE provides that the median loss to governments due to employee fraud was \$45,000<sup>8</sup>.

The potential magnitude of losses of public funds due to illegal acts by employees warrants that all governments need to be aware as to what the fraud risks are in their

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<sup>3</sup> Forbes.com “General Electric Company Details” retrieved on May 21, 2005 from <http://www.forbes.com/finance/mktguideapps/compinfo/CompanyTearsheet.jhtml?cusip=369604103>.

<sup>4</sup> Association of Certified Fraud Examiners, *2004 Report to the Nation on Occupational Fraud and Abuse*, p. 8.

<sup>5</sup> Receiver General for Canada, *2004 Public Accounts of Canada Volume 2*, p. 1.3

<sup>6</sup> Association of Certified Fraud Examiners, p. 17.

<sup>7</sup> Association of Certified Fraud Examiners, p. 17.

various departments and agencies as well as the areas in the governmental structure most susceptible to fraud or theft.

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<sup>8</sup> Association of Certified Fraud Examiners, p. 7

## **5.0 A Model Reporting Framework**

Governments of all levels, and their departments and agencies employ many people and are responsible for millions and billions of taxpayer dollars. No organization's internal controls can completely prevent losses due to illegal acts by employees, and this hold true for governments. It is important that governments implement policies and procedures that ensure these losses are reported by the departments and agencies in an expeditious manner. These policies and procedures will ensure that departments and agencies are held accountable for the public funds under their control and will ensure that the use of public funds is transparent to taxpayers.

It is also important that these policies and procedures improve detection, promote deterrence and educate employees about the implications of these crimes. A well-structured framework will encourage voluntary reporting of fraud incidents by employees. The components of the model framework in this section have been extracted from the policies and procedures of the governments of the various jurisdictions that were surveyed for this paper. A best practices reporting framework will include the following components:

1. Requirement to report
2. A mechanism to facilitate reporting
3. Disciplinary measures for non-reporting
4. Protection from employer retribution
5. Investigation methodology
6. Prosecution and/or recovery

## 7. Public reporting

### **5.1 Requirement to Report**

Ideally, governments should implement a policy, or legislation that requires any government employee to report all known incidents of losses of public money due to actual or suspected illegal acts. Legislation will hold more weight than an administrative policy, especially since non-compliance with legislation will usually result in some sort of punishment (see section 5.3 below). Reporting should be directed to a government agency or official with investigation powers over the entity in which the incident occurred. In most jurisdictions, the Auditor General or State Auditor is in such a position and is usually an independent office.

This step is important as departments and agencies must be held accountable for the public funds that they receive. Another reason that this step is imperative is that some governments have fidelity insurance on various employees and it is usually a requirement of the insurer that any claims be made within a short, specified time period.

### **5.2 Mechanism to Facilitate Reporting**

The easier a government makes it for an employee of a department or agency to voluntarily report incidents of fraud, theft and other illegal acts to the designated official, the greater the likelihood the employee will communicate his or her knowledge of the incident. Governments should implement a hotline or web-based

form that will allow employees easy access to methods of providing the required information about the incident in a secure and confidential manner. An employee cannot be expected to visit an office to provide information in person.

### **5.3 Disciplinary Measures for Non-Reporting**

In order for any requirement to hold weight, it must be enforceable. Enforceability becomes easier when a punishment is mandated for the violation of the requirement. This is one reason why legislation is more effective than internal policies. Violation of legislation usually has repercussions associated with it, be it a fine, suspension or even imprisonment. A strict government policy of ensuring that all violators of the reporting requirements are punished not only helps to ensure that the requirements are abided by, but also acts as a deterrent to future incidents. Employees witnessing the ramifications to colleagues of non-compliance with reporting requirements will be more likely to follow the appropriate reporting procedures.

### **5.4 Protection from Retaliation**

If a government implements appropriate requirements for employees to report incidents of fraud and theft by other employees, it should ensure that there is an adequate process in place to protect that employee from retaliation from his or her employer. This protection is commonly found in whistleblower legislation that is in effect in many jurisdictions. The purpose of this legislation is to prohibit retaliation against an employee's employment terms and conditions for reporting illegal acts as required by policy or legislation. Without this protection being provided, many

employees would not risk losing their jobs and would be more likely to violate reporting requirements.

### **5.5 Investigation Methodology**

Governments should ensure that an adequate methodology exists for investigating the incidents reported by the employees of departments and agencies. Ideally the reported information should be provided to an agency that has investigative powers and that is independent. Most jurisdictions have offices or agencies that report directly to the legislative assembly; usually this office is the Auditor General or the State Auditor. All information provided about agencies that are within the investigative authority of the investigating should be initially reviewed to determine if evidence exists to warrant an in-depth investigation.

### **5.6 Prosecution/Recovery**

A government that has been the victim of a crime committed by an employee of a department or agency should ensure that all steps are taken to prosecute the suspected individual and to recover as much of the misappropriated public funds as possible. It is important that governments send a clear message to their employees that fraud and theft will not be tolerated and will be fully prosecuted. Following through on this threat is the ultimate deterrent; employees witnessing their colleagues being prosecuted will be less likely to commit a crime themselves. The government should also ensure that all recoverable funds are recovered. There are mechanisms through the courts that will order a suspect, upon conviction, to pay restitution. Governments,

like all other institutions, must consider the costs and benefits of these prosecutions. However, given their public nature and their responsibilities for public funds, there may be even more of an imperative for them to initiate such recovery measures.

### **5.7 Public Reporting**

Many governments are reluctant to report publicly on losses of public money. There are many reasons for this including embarrassment and negative publicity. Public reporting of losses due to illegal acts by employees helps a government to be transparent and accountable to the taxpayers it serves. A government that shows it was a victim of theft or fraud, how it happened and what steps have been taken to deal with the issue is far more credible than a government that provides no public reporting at all.

### **5.8 Overview**

The components indicated above are explained in detail throughout this report. Recommendations have been provided along with additional reasons, based on cited examples, as to why certain framework concepts are desirable. Certain of the components are explained in their own section, while others are explained in tandem as this allows for the most efficient and understandable method of presentation.

Subsequent to the discussion of the framework components, this paper will explore the effectiveness of government policies surrounding employee fraud, prevention of employee fraud and opportunities for the IFA in the government environment.

## **6.0 Requirement to Report and Investigate Losses**

There are primarily two methods by which a government can require its departments and agencies to report actual or suspected losses due to illegal acts; through internal policies or through legislation. The requirements widely differ from jurisdiction to jurisdiction. In Canada, nine provinces have developed internal policies and guidelines that require all government departments and agencies to report these losses to a person or department, usually the Comptroller or the Minister of Finance. There is no legislation enacted for either the federal or provincial governments in Canada requiring the reporting of these losses.

There are 14 U.S states that have enacted legislation requiring anyone aware of actual or suspected illegal actions causing the loss of public money to report such information. This legislation requires the reporting of anyone misusing public funds, not just employees. The remaining 36 U.S. states have no requirement requiring that public servants report any knowledge of illegal acts. Appendix 1 provides information with respect to which states have legislated this requirement.

### **6.1 Canada**

The Canadian government's directive to its employees in the area of reporting losses due to illegal activities of employees is presented as a Treasury Board Policy entitled *Policy on Losses of Money and Offenses and Other Illegal Acts Against the Crown*. This policy is in quite detailed and includes a significant number of different illegal acts as well as their definitions. Interestingly, the Policy does not require that losses

be reported internally; however the Policy does require reporting through Public Accounts (to the public) as well as to the RCMP when necessary. The Policy Statement of this Policy states:

*“It is government policy that:*

- *all losses of money and allegations of offences, illegal acts against the Crown and other improprieties be fully investigated;*
- *suspected offences be reported to the responsible law-enforcement agency;*
- *losses and offences be reported to Parliament through the Public Accounts;*
- *losses be recovered whenever possible;*
- *measures be implemented to prevent future recurrences of losses and offences;*
- *when a department considers that circumstances warrant it, disciplinary action be taken; and*
- *managers who fail to take appropriate action or who directly or indirectly tolerate or condone improper activity be themselves held to account.”*<sup>9</sup>

The fact that the Policy requires that incidents be reported through Public Accounts would by default require that the instances be reported to the Receiver General as that office publishes the Public Accounts. The policy does not require reporting to the Auditor General of Canada, which is the independent investigative body for the federal government.

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<sup>9</sup> Treasury Board of Canada, *Losses of Money and Offences and Other Illegal Acts Against the Crown – Policy statement*. Retrieved from [http://www.tbs-sct.gc.ca/pubs\\_pol/dcgpubs/TBM\\_142/4-7-1\\_e.asp](http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/TBM_142/4-7-1_e.asp) on June 1, 2005.

## **6.2 Provincial Governments**

Typically, Provincial governments publish manuals (often known as Financial Administration Manuals) through the Department of Finance that outline procedures to be followed in various situations related to the financial administration of public funds. These procedures often include a requirement to report losses due to illegal acts to the head of the department. The policy often requires the department to investigate the incident, notify the proper legal authorities and ensure controls are implemented to prevent the occurrence of a similar incident. The department head is then required to notify the appropriate government official, usually the Provincial Comptroller or the Minister of Finance, of the details of the investigation. There is no legislation in Canada, either federally or provincially, requiring the reporting of illegal acts to a government department, only the internal policies explained here. Appendix 2 indicates which provinces require the reporting of fraud and illegal acts, and to whom these incidents must be reported.

Through a discussion with the Director, Insurance and Risk for the Province of Manitoba, it was provided that it is his opinion that about half of the provinces do not have insurance through a bonding company for their employees. The reason for this is that typically, fidelity insurance is good only until an incident occurs, after which time, premiums no longer remain affordable. This was confirmed by the Insurance and Risk Manager for Nova Scotia which has lost its fidelity insurance due to a very large claim. There is an exception to this for employees in government departments

responsible for high-risk areas such as casinos. Fidelity insurance is usually purchased for these employees.

### **6.2.1 Manitoba**

The Manitoba Department of Finance has developed a fraud prevention and reporting policy which is published in the Financial Administration Manual (FAM) and is available on-line to all government departments. *“This policy is applicable to all intentional acts, or failures to act, which are carried out with the intent to deprive the Province of Manitoba of its rights, or which result in increased expenses or loss of assets by the Province, including theft, misappropriation or embezzlement (or attempt thereof)”*.<sup>10</sup> There are several other incidents to which this policy is applicable, such as bid-rigging and breach of trust by a public officer; however this paper will concentrate on the area of fraud and theft.

The FAM requires, among other things, that all Manitoba government *“entities take reasonable measures to minimize the risks of fraudulent activity”*<sup>11</sup>. The manual then provides guidance as to what steps to take following a loss from a fraudulent activity. These steps are:

1. “When a loss occurs due to a fraudulent activity, immediate steps should be taken to prevent further loss by altering the conditions that contributed to the original loss (e.g., upgrading of office security measures, altering cash handling practices, re-assigning cash handling staff, etc.)
2. Disciplinary action against the individual(s) involved should be taken only after consultation with the Deputy Minister or head of the Government entity and the Human Resource unit.

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<sup>10</sup> Province of Manitoba, Department of Finance *Financial Administration Manual* section 9A-2.0, pg. 1.

<sup>11</sup> Province of Manitoba, Department of Finance, section 9A-2.0, pg. 1.

3. Legal action against the individual(s) involved should be taken only after the Deputy Minister or head of the Government entity or their designate has consulted with the police.
4. It is recommended that law enforcement authorities and insurance company representatives (if applicable) be consulted early in the investigation to determine how recoveries from the person(s) responsible can be maximized.
5. All efforts must be made to recover the loss, including making recoveries from the person(s) responsible.”<sup>12</sup>

The FAM states that all employees of the Government of Manitoba “*are required to report all incidents of fraud or suspected fraud to their supervisor once they become aware of the situation*”<sup>13</sup> and also provides a prescribed form to be used to report such incidents. Exhibit 6.2.1 presents the current form in use by the Province of Manitoba. Although the manual requires that employees report occurrences coming to their attention, the FAM does not provide any penalty for failure to report these occurrences.

Annually, within 3 months of the fiscal year end, all government departments must summarize the actual and suspected fraud incidents for the fiscal year for reporting to the Insurance and Risk Management Branch of the Department of Finance. The reports received by this Branch are consolidated and forwarded to appropriate departments including the Minister of Finance and the Auditor General.

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<sup>12</sup> Province of Manitoba, Department of Finance, section 9A-2.0, pg.2.

## Exhibit 6.2.1

| ANNUAL FRAUD SUMMARY REPORT <span style="float: right;">9A-2.3</span>                       |                       |                         |                                 |                          |                              |                |
|---|-----------------------|-------------------------|---------------------------------|--------------------------|------------------------------|----------------|
| REPORTING PERIOD _____  |                       |                         |                                 |                          |                              |                |
| DEPARTMENT/AGENCY _____   |                       |                         | PREPARED BY _____               |                          |                              |                |
| ACTUAL FRAUD INCIDENTS: _____ (NUMBER) or _____ (NIL)                                       |                       |                         |                                 |                          |                              |                |
| DATE OF LOSS  | EMPLOYEE NAME         | DESCRIPTION OF INCIDENT | ESTIMATE OF LOSS (\$)           | RECOVERIES (IF ANY) (\$) | DISCIPLINARY OR LEGAL ACTION | FURTHER ACTION |
|   |                       |                         |                                 |                          |                              |                |
|   |                       |                         |                                 |                          |                              |                |
|   |                       |                         |                                 |                          |                              |                |
| TOTAL   |                       |                         |                                 |                          |                              |                |
| SUSPECTED FRAUD INCIDENTS: _____ (NUMBER) or _____ (NIL)                                    |                       |                         |                                 |                          |                              |                |
| DATE OF LOSS  | ESTIMATE OF LOSS (\$) | DESCRIPTION OF INCIDENT | CURRENT STATUS OF INVESTIGATION | CORRECTIVE ACTION TAKEN  |                              |                |
|   |                       |                         |                                 |                          |                              |                |
|   |                       |                         |                                 |                          |                              |                |
|   |                       |                         |                                 |                          |                              |                |
| TOTAL   |                       |                         |                                 |                          |                              |                |
| Forward to: Insurance and Risk Management<br>Department of Finance<br>417 - 401 York Avenue |                       |                         |                                 |                          |                              |                |

### 6.2.2 British Columbia

The Core Policy and Procedures Manual prepared by the B.C. Ministry of Finance outlines the Province’s “Fraud, Embezzlement, Misappropriation and Theft of Public Money and Assets”<sup>14</sup> Policy. This policy states, “whenever employees have reason to believe that a loss is due to a fraud, embezzlement, misappropriation, or theft...they must immediately inform their supervisor and the ministry’s executive financial officer.”<sup>15</sup> The executive financial officer is to consult with the Comptroller General on the appropriate course of action when the case allegedly involves ministry employees. When an investigation into a loss is completed, the Comptroller General is to be informed of “the measure taken to recover the loss, the amount recovered and probability of further recovery; the action or discipline taken in respect of the loss

<sup>13</sup> Province of Manitoba, Department of Finance, section 9A-2.1, pg. 2, Note 1.

<sup>14</sup> British Columbia, Ministry of Finance, *Core policies and Procedures Manual*, Section 8.3.4. Retrieved from [http://www.fin.gov.bc.ca/ocg/fmb/manuals/CPM/08\\_Assets.htm#834](http://www.fin.gov.bc.ca/ocg/fmb/manuals/CPM/08_Assets.htm#834) on May 15, 2005

including the extent to which prosecution has been undertaken and if so, the result of the prosecution; and the safeguards and controls implemented or planned to be implemented to prevent, reduce and detect further losses of a similar nature.”<sup>16</sup> British Columbia’s policy does not require the reporting of incidents of fraud to an independent agency with investigation powers, the Auditor General, for example.

### **6.2.3 Alberta**

Alberta has implemented a detailed policy for responding to alleged criminal conduct by employees. Ministries in Alberta are expected to follow these detailed procedures when investigating allegations. Ministries are required to “establish investigative principles”<sup>17</sup> which include such things as establishing terms of reference for the investigation and relieving the suspect employee of his or her employment duties during the investigation to ensure the investigation is not hindered. If there are reasonable findings to support that the employee committed a criminal offense at any point during the investigation, the incident must be reported to the Director of the Special Prosecutions Branch. This policy, however, does not require incidents to be reported to a government department or official, such as the Auditor General or the Provincial Comptroller. The failure to require reporting of incidents outside of the affected department does not provide adequate accountability to the government by the Ministries. It is unlikely that a Ministry would report losses to the government if not required.

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<sup>15</sup> British Columbia, Ministry of Finance, paragraph 1

<sup>16</sup> British Columbia, Ministry of Finance, paragraph 4

<sup>17</sup> Alberta Personnel Administration Office, *Response to Alleged Criminal Conduct by Employees*, p. 2

#### **6.2.4 Saskatchewan**

The Saskatchewan Department of Finance has prepared a section in the “Financial Administration Manual” The Section is entitled “Reporting and Recovery of Losses.” The policy applies to all government departments and requires that departments report all cases of theft and fraud to the proper authorities as well as ensuring that adequate systems exist to reduce the risk of loss. There is a hierarchy of notification required depending on the nature and amount of the loss. Losses are reported to the police if they are greater than \$200. All losses that appear to be the result of employee theft or fraud are reported to Saskatchewan Government Insurance for recovery through fidelity bonds where possible. The Provincial Comptroller is notified of all losses in excess of \$500. Departments are required to take appropriate steps to prevent a similar event from occurring in the future. There is no direction in the policy for investigation of the incidents or for the reporting of incidents to an independent agency with investigative powers.

#### **6.2.5 New Brunswick**

The requirements for reporting losses in New Brunswick are similar to those described for British Columbia, Saskatchewan and Manitoba. Policy AD-6604, “Financial Management – Loss of Intangible Public Assets” requires that any public servant discovering an actual loss or suspecting a loss due to fraud, theft, misappropriation, embezzlement or negligence must report their findings to the deputy head of the public servant’s department. Having confirmed the loss or suspicion is valid; the deputy head must report the loss or suspicion to the

Comptroller in writing. The information reported must contain the following information:

- a) nature and extent of the loss or suspected loss, if known;
- b) circumstances surrounding the discovery of the loss or suspicion of loss; and
- c) the name and position of the public servant believed responsible or that is suspected for the loss.

The policy requires that the loss be reported upon confirmation; there is no requirement for New Brunswick departments and agencies to investigate the incidents. There is no requirement in New Brunswick that this information be forwarded to the Auditor General or another independent investigative body.

#### **6.2.6 Prince Edward Island**

Prince Edward Island has established Treasure Board Policy 21.01 “Fraud Awareness and Reporting”. This policy states:

*“government employees are expected to report to their supervisor all suspected or known cases of fraud as soon as the employee becomes aware of the incident, be it internal or external. Failure of an employee to report such instances promptly can be considered as employee misconduct and may result in disciplinary action being taken against the employee for failure to report”*.<sup>18</sup>

Prince Edward Island is the only provincial government in Canada to provide notice that the failure of an employee to report these instances is grounds for disciplinary

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<sup>18</sup> Prince Edward Island, *Treasury Board Policy*, Section 21, paragraph 6(a)

action; however it does not outline the disciplinary action. As will be discussed later in this paper, it is important to ensure there is a resulting punishment to an employee for not following a policy requiring the reporting of fraud. Prince Edward Island's policy does not provide any direction for investigation. All investigation decisions are made by the Attorney General's Office.

### **6.2.7 Nova Scotia**

"The Budgeting and Financial Manual", subsection 1.04, prepared by the Department of Finance requires that the Department of Finance be notified of any of the following types of losses:

1. *"Any person who has willfully or negligently omitted to collect or receive any public money belonging to the Province*
2. *Any public money which was not accounted for and paid into the Consolidated Fund or any other account, Fund or Trust Fund for which the money was intended;*
3. Deficiency or loss due to:
  - *theft*
  - *fraud*
  - *falsification of records*
  - *default*
  - *error*
4. *Loss of funds or property through:*
  - *break*
  - *entry*
  - *theft*
  - *fire*
  - *malicious damage*"<sup>19</sup>

The manual also requires that the Nova Scotia Auditor General be notified of any losses greater than \$1,000 and all losses where fraud is suspected. *The Auditor*

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<sup>19</sup> Government of Nova Scotia Management Manual 200, Chapter 8, Page 2, paragraph 1.04

*General Act* then requires the Auditor General to report in every case where public money has not been fully accounted for. Similar to the New Brunswick policy, departments are not required to investigate incidents in Nova Scotia. The Auditor General has the power to investigate any losses that are reported to his Office.

### **6.2.8 Yukon**

The Yukon government's "Financial Administration Manual", Chapter 8, requires that for any loss due to fraud, embezzlement and theft that "*the Deputy Minister of Finance be notified as the Department [of Finance] will assist in determining the amount of the loss and how to account for it.*"<sup>20</sup> A report of the incident must be forwarded to the Department of Finance along with a signed cheque requisition to allow the Department of Finance to replenish the misappropriated funds. The requirement of a cheque requisition is unique to the Yukon. There is no mention in Yukon's policy about investigating the loss or any requirement to report losses to an independent body with investigative powers.

### **6.2.9 Northwest Territories**

The government of the Northwest Territories has included a policy in the "Financial Administration Manual" that requires that "*when a public officer has reason to believe that a loss or offence has occurred, the public officer shall immediately notify their supervisor in writing.*"<sup>21</sup> The supervisor is then required to report to the Deputy Head who must report to the Comptroller General. The Comptroller General is

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<sup>20</sup> Yukon Finance, *Financial Administration Manual*, Chapter 8.2.2

responsible for investigating and reporting to the RCMP where necessary. The policy indicates that the Comptroller General may consult with the Audit Bureau if necessary. The Audit Bureau should be consulted in all cases. The Auditor General of Canada is the legislative auditor for the Northwest Territories and should be provided loss information as it could impact the government's audit.

### **6.3 United States and Other Jurisdictions**

#### **6.3.1 U.S. State Governments**

The requirements for the reporting of losses due to illegal acts by employees vary drastically throughout the United States. Appendix 1 indicates that 14 State Governments have enacted legislation that requires the reporting of known or suspected loss of public funds or assets due to illegal actions. The legislation varies widely as to which government agency or department must be notified of the loss. Many states have also enacted whistleblower legislation that allows state employees or citizens to report fraud or abuse of public money to the appropriate government department without fear of reprisal. Whistleblower legislation is discussed in section 9.0 of this paper. See Appendix 1 for a summary of the legislation for each State.

Selected states with legislation in effect or policies implemented requiring the reporting of known or suspected losses due to illegal acts by government employees are discussed here. This is not an exhaustive list. The states profiled here have been

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<sup>21</sup> Northwest Territories, Financial Administration Board Secretariat, *Financial Administration Manual*, Directive 913, Section 4.3, retrieved from <http://www.gov.nt.ca/FMBS/documents/FAMWeb/index.html> on May 29, 2005.

chosen primarily because they provide good examples of reporting requirements for these losses.

### **6.3.2 California**

California has implemented a policy to direct employees on procedures to follow upon discovering the loss of public money due to illegal acts. *The State of California Administrative Manual*, Section 20080<sup>22</sup>, requires all state agencies to notify the Bureau of State Audits of actual or suspected incidents of fraud, theft and other irregularities. This notification must occur within one business day of the incident, whether actual or suspected. The notification must include such information as the events; how internal controls were breached; the corrective actions taken; an estimated amount of loss; and any punitive action taken or being considered. As this is an internal policy, there is no penalty for non-reporting. The State Auditor of California, an independent body, reviews all incidents reported and investigates incidents where warranted.

### **6.3.3 Washington**

The State of Washington has enacted legislation that states, “*State agencies and local governments shall immediately report to the state auditor’s office known or suspected loss of public funds or assets or other illegal activity.*”<sup>23</sup> The Washington State Auditor’s Office reviews all incidents that have been reported. Reports are received

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<sup>22</sup> Retrieved from <http://sam.dgs.ca.gov/TOC/20000/20080.htm> on June 4, 2005.

<sup>23</sup> Revised code of Washington – 43.09.185. Retrieved from <http://www.leg.wa.gov/RCW/index.cfm?section=43.09.185&fuseaction=section> on May 19, 2005.

through a variety of methods and are discussed in subsequent sections of this paper. The State Auditor has the powers and authority to investigate these incidents where necessary.

#### **6.3.4 Texas**

“The Texas Government Code”, Section 321.022<sup>24</sup> requires that state agencies and universities report suspected fraud to the State Auditor’s Office when there are facts to support fraud or other illegal act. These entities are not required to report based on suspicions. Failure to report under the section indicated above is classified as a Class A misdemeanor. Under “The Texas Penal Code”, Section 12.21<sup>25</sup> a Class A misdemeanor has a maximum penalty of a \$4,000 fine; 1-year imprisonment; or both. Discussions with the Texas State Auditor’s Office revealed that this law has been in force since 1997 and no individual has yet been charged with such an offense.

“The Texas Penal Code” provides that thefts committed by public servants, of property coming into their possession as a result of their position as a public servant, are punished at the level of the next highest category. For example, a theft that is classified as a Class B misdemeanor would be punishable in this case by the punishments defined for a Class A misdemeanor.

Representatives of the Texas State Employees Union were asked in an interview what the union’s perspective was on employees being legally required to report instances

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<sup>24</sup> Texas Government Code. Retrieved from <http://www.capitol.state.tx.us/statutes/gv.toc.htm> on May 14, 2005.

of fraud. It would often be the case that complying with this legislation would result in one union employee reporting another union employee to the State Auditor. The official position of the union is that they agree with any legislation that would reduce fraud against the government.

### 6.3.5 Queensland, Australia

“Financial Management Standard – 1997” Section 42 requires that upon discovery of a loss, the accountable officer or statutory body must:

1. *“investigate the circumstances of the loss;*
2. *prepare a report about it; and*
3. *take action to prevent the loss recurring*

*If the accountable officer or statutory body suspects any loss to be a result of an offence under the Criminal Code or another Act, the accountable officer or body must also give written notice about the loss to:*

1. *a police officer; and*
2. *if official misconduct of an officer of a department or statutory body is suspected-the Criminal Justice Commission; and*
3. *the auditor-general*<sup>26</sup>

For all losses over \$500, the accountable officer or statutory authority must keep a record which includes information such as a description of the loss, the reason for the loss and measures taken to prevent recurrence. The Auditor General is notified of losses due to illegal acts.

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<sup>25</sup> Texas Penal Code. Retrieved from <http://www.capitol.state.tx.us/statutes/pe.toc.htm>, on May 10, 2005.

<sup>26</sup> Government of Queensland, Australia, *Financial Management Standard 1997*, Section 42. Retrieved from <http://www.legislation.qld.gov.au/LEGISLTN/CURRENT/F/FinAdminAudSt97.pdf> on June 10, 2005.

## **6.4 Summary and Recommendations**

### **6.4.1 Canada**

Of the thirteen provincial and territorial governments in Canada, nine governments have policies that require the reporting of losses, two do not have policies and two provinces did not respond to the survey (See Appendix 2). Of the nine policies that are in place in Canada, only Prince Edward Island mentions the impact to an employee of non-reporting. Employees must be made aware of the seriousness of fraud and theft and the impact it could have on the government. Employees must understand that non-reporting of known instances of fraud and theft will not be tolerated and will be punished. A policy with no punishment for non-compliance is difficult to enforce. A subsequent section will explore the effectiveness of these policies.

The two provinces with no reporting requirement expect that departments and agencies will follow-up losses due to fraud and theft with the appropriate law enforcement agency. The Department of Finance is not notified of the incidents and is not able to follow-up whether appropriate investigation procedures have been followed.

The policies of the governments of Manitoba, Nova Scotia are the only two jurisdictions in Canada that notify the Auditor General of losses of public money. Governments in Canada should implement a policy that requires that all losses in government departments and agencies, that are the result of an illegal act by an

employee, be reported to an independent agency with the authority and power to perform an investigation. An example of such an independent agency would be the Auditor General of each province. There should be a non-compliance punishment inherent in this policy to assist with enforcement. Canadian governments may wish to consider legislating these policies since laws can be more effectively enforced than an internal policy. Policies could be written to require the affected department and agency to perform a preliminary investigation before forwarding the Auditor General for further investigation.

#### **6.4.2 United States and Other Jurisdictions**

The U.S. states use a variety of methods to require reporting of losses due to illegal acts by their departments and agencies. Several states have enacted legislation that requires certain departmental employees to report any known losses to a specific state agency, usually the State Auditor. The effect of legislation is that an employee that is aware of incidents of fraud and theft of public money, but does not report it, would be breaking the law. In most states, with or without legislated reporting requirements, employees are protected from retaliation by their employer for providing information with respect to illegal acts committed by their employer or another state employee. This protection is offered under whistleblower legislation of each state and is discussed in section 9.0 in this paper.

The State Auditor's Offices (SAO) in many states have wide ranging powers and can usually investigate any incident involving state funds. All reports that are received by

the SAO are reviewed and investigated where necessary. Fraud incidents are taken very seriously by state governments and usually fully investigated and forwarded for prosecution.

All U.S state governments should learn from the few states listed in this section. Legislating the reporting of fraud sends a message to employees that fraud is a very serious issue and will not be taken lightly. Employees that are aware of fraudulent activity but refuse to report it, would then themselves be in violation of the law.

## **7.0 Internal Reporting and Public Information**

The preceding section of this paper explains the requirements that are in place for the reporting of losses due to illegal acts by government departments and agencies.

Although having these requirements in place is important, the information provided must be complete and timely to be useful to the government.

At least annually, governments should issue public reports disclosing all losses of public funds during the year and the amount of these losses that was recovered through various means. Taxpayers have a right to full accountability of public funds and this reporting will assist in providing this accountability.

### **7.1 Canada**

The Government of Canada is required to report all losses due to an offence, an illegal act or an accident through public accounts. Annually, the “Public Accounts of Canada” is published by the Receiver General and contains a listing of the required reporting. The listing details all losses for the fiscal year and is listed by department. The reporting does not specifically segregate losses due to illegal acts by employees and non-employees; however, in many cases the description of the loss leads to the conclusion that the loss is employee related. For example the descriptions “fraudulent use of credit card” and “fraudulent use of purchasing card”, while not specifically indicating employee involvement, would lead readers to conclude that the loss was employee related.

Readers are unable to determine the number of illegal acts committed by Federal public servants. Readers are, however, able to determine the amount of their tax dollars that were lost due to illegal activity. For the 2004 fiscal year there were total losses of public money and property reported of \$461.5 million.<sup>27</sup> This amount includes \$109 million of losses related to fraudulent claims for Old Age Security, Canada Pension Plan and Employment Insurance. The amount also includes a \$146 million amount for unsubstantiated claims for payment from suppliers and contractors<sup>28</sup>. “The Public Accounts of Canada” provides a very brief description of the losses and usually does not indicate whether or not an employee was involved.

## **7.2 Canadian Provinces**

As explained earlier, many Canadian provinces have internal policies that require losses from illegal activities be reported to a central government official, usually the Minister of Finance or the Comptroller. In most cases, the information that is reported under these policies is kept internally. Provincial governments are reluctant to report incidents of employee fraud and theft publicly. The reasons most often provided for non-disclosure by government officials interviewed were confidentiality and embarrassment, leading potentially to a reduction in the confidence of the government by the public. Detailed information of the loss information that was reported to Saskatchewan and the Yukon was obtained through a request under the *Freedom of Information and Protection of Privacy Act* (FIPPA). The same FIPPA request was

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<sup>27</sup> Receiver General for Canada, *2004 Public Accounts of Canada*, Volume 3, Chapter 3, pp 3.15 – 3.19. Retrieved from <http://pwgsc.gc.ca/recgen/pdf/v3pa04e.pdf> on June 10, 2005.

<sup>28</sup> Receiver General for Canada, pp 3.15 – 3.19.

made to British Columbia, Nova Scotia and New Brunswick. The information requested from these provinces was not received in time for inclusion in this paper.

Detailed information was received from Manitoba, Saskatchewan and the Yukon and these three governments are discussed in this section.

### **7.2.1 Manitoba**

The incidents that are reported in Manitoba are reported in a standard format and include the following information:

- Date of Loss
- Employee Name
- Description of incident
- Estimate of Loss
- Recoveries (if any)
- Disciplinary or Legal Action
- Further Action

The incidents are separated into actual and suspected losses. For the purposes of this paper the discussion will focus on actual losses. The information that has been reported for the last five fiscal years in Manitoba is summarized in Exhibit 7.2.1.<sup>29</sup>

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<sup>29</sup> Province of Manitoba, Fraud Reports of Departments and Agencies, 2000-2004.

**Exhibit 7.2.1.**

| <b>Fiscal Year</b>  | <b>Number of Incidents Reported</b> | <b>Amount of Loss</b> | <b>Amount Recovered</b> | <b>Terminations</b> | <b>Prosecutions</b> |
|---------------------|-------------------------------------|-----------------------|-------------------------|---------------------|---------------------|
| <b>2000</b>         | 6                                   | \$ 17,810             | \$ 150                  | 6                   | 0                   |
| <b>2001</b>         | 4                                   | 19,352                | 17,658                  | 2                   | 1                   |
| <b>2002</b>         | 5                                   | 119,152               | 314                     | 4                   | 3                   |
| <b>2003</b>         | 5                                   | 14,665                | 13,301                  | 4                   | 2                   |
| <b>2004</b>         | 4                                   | 18,933                | 6,690                   | 3                   | 0                   |
| <b>5-Year Total</b> | 24                                  | \$ 189,912            | \$ 38,113               | 19                  | 6                   |

Manitoba government departments and agencies reported 24 cases of fraud by employees in the five fiscal years spanning 1999 to 2004. The total amount of confirmed losses due to fraud was \$189,912 or \$7,913 per incident. Recovery amounted to \$38,113 or 20%. The reason for such a low recovery rate is likely the fact that only six incidents were forwarded for prosecution. Pursuing prosecution on fraud and theft cases provides the government with ability to have the courts order restitution as part of the sentence.

The government of Manitoba does not provide any information to its citizens with respect to losses due to illegal acts, whether from employees or non-employees. The information that has been received for use in this section is not available to the public.

Three of the incidents which indicated that the case was forwarded for prosecution were followed up with the assistance of a court clerk at the Manitoba Courts.

### **Case 1**

The information reported by the department indicated that over a three-year period, an employee fraudulently used a procurement card. The estimated loss was \$100,000. The information indicates that charges were laid which are before the courts (at the time of the filing of the report). Manitoba courts provided information that this individual was convicted of fraud and was sentenced to 2 years less a day imprisonment. Restitution of \$66,300 was also ordered.

### **Case 2**

The information reported by the department indicated that an individual committed a theft of more than \$10,000. The information also indicated that the case was forwarded for prosecution. However, Manitoba Courts conducted a search and determined that a court never received this case. This information should be a concern to the government because information provided to the government is inconsistent with the actual actions taken by the department or agency.

### **Case 3**

The information provided indicated that an individual fraudulently issued payments to herself in the amount of approximately \$9,000. It is also indicated that the individual was charged with fraud and theft under \$5,000 and ordered to pay restitution of \$4,350. Manitoba Courts confirmed this information.

The information reported on two of these three cases was confirmed as being correct by a discussion with a Manitoba court clerk. One case was indicated as being forwarded for prosecution but was never received by a court. The information is reported by departments in accordance with policy; however, the government does not follow-up cases that are reported.

The number of cases reported by Manitoba departments and agencies over this 5 year period (24), does not appear to be realistic. There are no reports from high risk agencies such as Manitoba Lotteries which operates the province's casinos. The Director of Insurance and Risk Management for Manitoba has indicated that it is clear that all instances of fraud and theft are not being reported; however there is no way to force departments and agencies to comply. The government can only request that these reports be made, there is no way under the existing Manitoba legislation that the departments and agencies can be compelled to report this information.

### **7.2.2 Saskatchewan**

The information reported under the "Reporting and Recovery of Losses" policy explained in the preceding section on reporting requirements was requested from the Office of the Comptroller for Saskatchewan. This first request was denied. A formal request for the desired information was then made under the Freedom of Information and Protection of Privacy Act (FIPPA). This request was granted and the information was finally provided. A total of 4 incidents were reported covering the five-year

period ending March 31, 2005<sup>30</sup>, but only two involved government employees. The total misappropriated amount was \$8,686. The Province of Saskatchewan does not make this information available to the public, except through a request under FIPPA.

In addition to the information that was provided above through a FIPPA request, information was received from Saskatchewan Risk Management. This information indicated that there are two large fraud investigations underway in Saskatchewan, one amounts to approximately \$1 million and the other amounts to \$300,000. This information was not included in the information that was provided by the Comptroller's office. The Provincial Auditor has reported on these two incidents in his 2005 – Volume 1 report. The Comptroller of Saskatchewan was telephoned to discuss this discrepancy. He confirmed that the information was indeed reported in accordance with the policy but cannot be provided under a FIPPA request as the matter is still under investigation by the RCMP.

### **7.2.3 Yukon**

For the period of September 2001 to March 2005, there were fourteen incidents reported to the Department of Finance of the Government of Yukon<sup>31</sup>. The total loss of these fourteen incidents was \$8,672, an average of \$619 per incident. Of the loss amount, there were total recoveries of \$630.

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<sup>30</sup> Information provided by the Saskatchewan Department of Finance through a request under the *Freedom of Information and Protection of Privacy Act*,

<sup>31</sup> Government of Yukon, *Reports Submitted pursuant to 8.2.2*.

To put the number of reported incidents in perspective it is important to remember that the population of Manitoba is approximately 25 times that of the Yukon. This would again appear to indicate that the number of reported incidents in Manitoba may be lower than the actual number of incidents.

Of the 14 incidents, 8 were reported to the RCMP with no indication of any further action taken. The remaining six cases, including the largest incident in the amount of \$5,200, resulted in no action being taken. The information provided by the Yukon does not indicate whether or not the suspect was an employee. Information with respect to losses in the Yukon Government is not reported in a publicly available document.

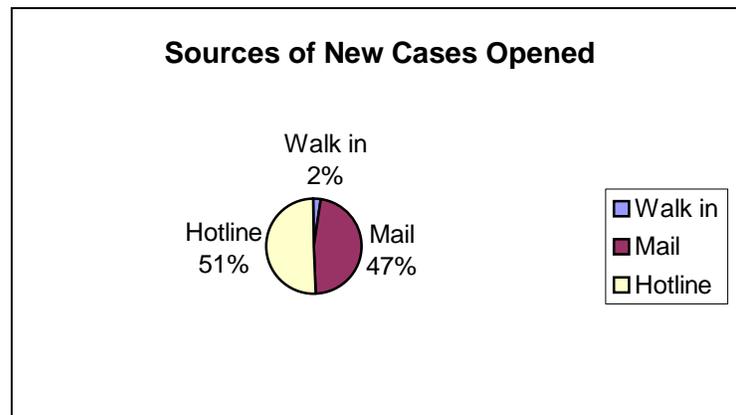
### **7.3 United States and Other Jurisdictions**

The public reporting of government employee fraud and theft incidents varies greatly depending on the state. Some states such as California, Texas and Washington provide detailed information with respect to improper activities by state employees and this information will be discussed in this section. Other states, such as Pennsylvania and Nebraska provide only summary information. The Office of the Inspector General for Pennsylvania reports very generalized information about some of the cases it handled during the year. Still other states, such as Montana and North Dakota provide no public information on cases of government employee fraud and theft.

### 7.3.1 California

The California State Auditor publishes a report entitled “Investigations of Improper Activities by State Employees” twice each year, with each report usually covering a six- month period. These reports present, in detail, results of investigations completed during each six-month period. Information on possible investigations is reported to the State Auditor in one of three ways: walk-in, mail-in and hotline. Exhibit 7.3 depicts the number of complaints received through each method in the five-year period from January 2000 to December 2004.<sup>32</sup>

**Exhibit 7.3**



The total number of incidents reported to the State Auditor in the five-year period from January 2000 to December 2004 was 2,089. Many cases are closed due to the State Auditor’s Office determining that there was insufficient evidence to warrant an investigation. For the five-year period ending December 2004, The California State Auditor investigated 410 cases in-depth. This includes 135 cases by the State Auditor’s Office itself and 275 cases by other state agencies on behalf of the SAO.

<sup>32</sup> Statistics used for California are derived from accumulating information from the California State Auditor’s reports entitled *Investigations of Improper Activities by State Employees* for the period January 2000 to December 2004. These reports were retrieved from <http://www.bsa.ca.gov/reports/list.php?mode=inv> on May 13, 2005.

The California reports provide the results of investigations, which include many types of improper activities. Incidents such as using a state vehicle to attend a personal court case and state employees using company time to participate in an NFL pool are included in the report. In the five-year period, the California State Auditor has identified improper government activities totaling \$1.6 million

In addition to these investigations that are initiated by the SAO several incidents are reported to the SAO in accordance with the State Administrative Manual policy explained in the Reporting Requirements section above. For the four-year period ending December 2003, there were 212 actual or suspected incidents of irregularity reported to the SAO. These incidents resulted in monetary loss to the State of California of \$2,875,259. This information has not been provided for the 2004 calendar year.

California also provides details as to the corrective actions taken (i.e. punishment) as a result of the SAO's investigations. Exhibit 7.3.1 outlines corrective actions taken by state agencies as a result of SAO investigations. In instances where corrective action has not been taken by agencies at the time of reporting, a follow-up is prepared and reported in a subsequent period.

**Exhibit 7.3.1**

| <b>Corrective Actions<br/>California<br/>January 2000 to December 2004</b> |                  |             |
|--|------------------|-------------|
| <b>Type of Corrective Action</b>   | <b>Incidents</b> | <b>%</b>    |
| Referrals for criminal prosecution   | 5                | 3%          |
| Convictions  | 3                | 2%          |
| Job terminations   | 25               | 13%         |
| Demotions  | 4                | 2%          |
| Pay reductions   | 38               | 19%         |
| Suspensions without pay  | 6                | 3%          |
| Reprimands   | 116              | 59%         |
|  | <b>197</b>       | <b>100%</b> |

**7.3.2 Texas**

The Special Investigation Unit (SIU) of the Texas State Auditor’s Office reports on all investigations of the unit. The reports contain summaries of the investigation as well as the detailed report on the investigations. Between 2000 and 2004 there are 25 reports<sup>33</sup> by the SIU, 13 contained illegal acts by state employees. The results of these 13 cases are summarized in Exhibit 7.3.2.

The reports of the SIU contain information that is not found in reporting by any other government with the exception of Mississippi. The reports from the Texas SIU contain the names of the perpetrators of the fraud as well as information relating to the indictments of the individuals. An individual (Pam Munn) in the Texas SIU was asked why names are included. The response was that it is felt that reports are more credible when names are included as well as acting as a deterrent to future fraudulent

<sup>33</sup> These reports were retrieved from <http://www.sao.state.tx.us/reports/reportpost.cfm/reporttitle/Special%20Investigations> on May 15, 2005.

acts by employees. Individuals will reconsider committing the fraud if getting caught will result in being named in a publication of the State Auditor's Office.

**Exhibit 7.3.2**

| <b>Texas State Auditor's Office<br/>Special Investigations Unit<br/>Reports on Employee Fraud Investigations<br/>2000 - 2004</b> |                       |                      |                                 |  |
|--|-----------------------|----------------------|---------------------------------|--|
| <b>Case</b>  | <b>Amount of Loss</b> | <b>Type of Crime</b> | <b>Resolution</b>               |  |
| 1  | \$ 11,000             | Fraud                | Conviction                      |  |
| 2  | 5,985                 | Fraud                | Restitution / Community Service |  |
| 3  | 1,800                 | Theft                | Indictment                      |  |
| 4  | 15,000                | Theft                | 5 indictments                   |  |
| 5  | 417,000               | Theft/Fraud          | 8 indictments                   |  |
| 6  | -                     | Intent to Defraud    | Indictment                      |  |
| 7  | 28,100                | Theft                | Conviction                      |  |
| 8  | -                     | Fraud                | Indictment                      |  |
| 9  | 805,000               | Theft/Fraud          | Indictment                      |  |
| 10   | 6,898                 | Theft                | Conviction                      |  |
| 11   | 905,000               | Fraud                | Conviction                      |  |
| 12   | 3,402                 | Theft                | Indictment                      |  |
| 13   | 2,859                 | Theft                | Indictment                      |  |
|  | <u>\$ 2,202,044</u>   |                      |                                 |  |

**7.3.3 Washington**

The State Auditor's Office (SAO) publishes a summary all fraud investigations. The SAO indicates that in 18 years of fraud investigations, the average number of fraud investigations is 36 amounting to an average of approximately \$700,000 per year<sup>34</sup>.

The jurisdiction of the Washington State Auditor includes county and municipal governments as well as universities and colleges, and as such, the fraud figures for Washington include these governments and institutions. Exhibit 7.3.3 summarizes the frauds reported by the Washington State Auditor for the years 2002, 2003 and 2004:

<sup>34</sup> Washington State Auditor's Office, Fraud program <http://www.sao.wa.gov/Fraud/Index.htm>

**Exhibit 7.3.3**

| <b>Summary of Audit Reports Disclosing Fraud<br/>                     Washington State Auditors Office<br/>                     2002 - 2004</b> |         |            |         |              |         |              |
|---|---------|------------|---------|--------------|---------|--------------|
|   | 2002    |            | 2003    |              | 2004    |              |
|   | Reports | Amount     | Reports | Amount       | Reports | Amount       |
| <b>State Agencies</b>   | 3       | \$ 7,265   | 27      | \$ 877,872   | 24      | \$ 952,105   |
| <b>Universities and Colleges</b>  | 8       | 78,885     | 3       | 110,929      | 0       | -            |
| <b>Local Governments</b>  | 36      | 245,653    | 32      | 1,264,593    | 32      | 170,223      |
| <b>Total</b>  | 47      | \$ 331,803 | 62      | \$ 2,253,394 | 56      | \$ 1,122,328 |

**7.3.4 Mississippi**

The State of Mississippi, through the State Auditor’s Office (SAO), issues a report each year entitled “Audit Exceptions”. The SAO provides that an “audit ‘exception’ indicates that a violation of the law has resulted in public funds being misappropriated or spent incorrectly”<sup>35</sup> As with the reports issued by Texas, the Mississippi reports indicated the name of the perpetrators as well as their sentence. The majority of cases that are investigated by the SAO result in restitution. Investigative audit exceptions result in a formal written demand being issued by the SAO and being transferred to the state’s Office of the Attorney General. Restitution is then paid to the SAO’s clearing account where it is held for 90 days. The SAO deducts the cost of its audit from the amount recovered and transfers the remaining funds to the Department or Agency that suffered the loss.

<sup>35</sup> Office of the State Auditor – Mississippi, Investigative Division Audit Exceptions, Fiscal year 2000, letter to citizens. Retrieved from <http://www.osa.state.ms.us/documents.asp> on May 28, 2005.

Table 7.3.4 follows the incidents of losses due to embezzlement, theft and fraud that are listed on the SAO's report for the 2000 fiscal year<sup>36</sup>. The reports for each year lists all cases, prior year's cases that are still open, as well as new cases investigated during that fiscal year. Readers are able to follow all of the exceptions through to final resolution. Table 7.3.4 also summarizes the results of the cases listed as investigative audit exceptions for the fiscal year 2000. All of the cases listed by the SAO involve losses resulting from actions of employees, however, for the purposes of this paper, only the incidents involving fraud, theft and embezzlement were examined.

**Exhibit 7.3.4**

| <b>Mississippi State Auditor's Office</b> |                |                     |                   |                   |  |
|---|----------------|---------------------|-------------------|-------------------|--|
| <b>Investigative Audit Exceptions</b>     |                |                     |                   |                   |  |
| <b>2000 Fiscal Year*</b>                  |                |                     |                   |                   |  |
| <b>Crime</b>                              | <b># Cases</b> | <b>Amount</b>       | <b>Recovery</b>   | <b>% Recovery</b> |  |
| Embezzlement                              | 21             | \$ 1,158,519        | \$ 595,741        | 51%               |  |
| Fraud                                     | 2              | 2,230               | 2,230             | 100%              |  |
| Theft                                     | 2              | 29,221              | 21,004            | 72%               |  |
| <b>Total</b>                              | <b>25</b>      | <b>\$ 1,189,970</b> | <b>\$ 618,975</b> | <b>52%</b>        |  |

\* Cases appearing in the 2000 fiscal year report. Represents all recovery as at 2004 fiscal year end.

All cases remain open until restitution is received in full or until the Office of the Attorney General advises that the case should be closed as further recovery is unlikely. The recovery rate of 52% presented in the chart is misleading due to the fact that there are two very large fraud cases totaling \$744,218 of which \$481,032 has not

<sup>36</sup> The fiscal year end for the State of Mississippi is June 30.

yet been recovered. Of the 25 cases listed in the 2000 report, 14 cases have been closed as the amount of the loss has been fully recovered. 10 cases remain open as payments continue to be made as directed by the courts as part of the perpetrator's sentence. Only one case has been closed upon the advice of the Attorney General's Office.

The reports prepared and issued by the Mississippi's SAO provide excellent accountability to the citizens of Mississippi. Taxpayers are informed as to the amount of public money that has been spent incorrectly or misappropriated due to the violation of a law by state employees. Taxpayers can also see that the state works to ensure that the misspent or taken funds are recovered, either through court order against the employee or by bonding company. The report is also effective as a deterrent against future incidents. Embarrassment results from having your name published in the SAO report and there is evidence that employees have been caught and punished.

### **7.3.5 United Kingdom**

Each year, HM-Treasury issues a report entitled "An Analysis of Fraud Reported in Government Departments".<sup>37</sup> For the purposes of this report, fraud includes theft, false accounting, bribery and corruption, deception and collusion. The report provides details on cases that exceed £20,000. The 2001-2002 version of this report provides

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<sup>37</sup> HM-Treasury, *Fraud Report, An analysis of reported fraud in government departments*. Retrieved from [http://www.hm-treasury.gov.uk/Documents/Public\\_Spending\\_and\\_Services/Audit\\_and\\_Accounting/pss\\_aud\\_fraud.cfm](http://www.hm-treasury.gov.uk/Documents/Public_Spending_and_Services/Audit_and_Accounting/pss_aud_fraud.cfm) on May 22, 2005.

11 case studies taken from actual fraud cases, to provide examples of the various types of frauds that can occur, how they occur and how they can be prevented.

Exhibit 7.4 gives a summary of the fraud cases reported by government departments in the United Kingdom for the 2002-03 and 2003-04 fiscal years.

#### **Exhibit 7.4**

| <b>United Kingdom</b>                          |                        |                  |            |                        |                  |            |
|--|------------------------|------------------|------------|------------------------|------------------|------------|
| <b>Analysis of Fraud by Departmental Staff</b> |                        |                  |            |                        |                  |            |
| <b>Type of Fraud</b>                           | <b>2003-04</b>         |                  |            | <b>2002-03</b>         |                  |            |
|  | <b>Number of Cases</b> | <b>Value £</b>   | <b>%</b>   | <b>Number of Cases</b> | <b>Value £</b>   | <b>%</b>   |
| T&S and allowances                             | 48                     | 28,500           | 0.73       | 76                     | 87,500           | 2.01       |
| Pay related fraud                              | 32                     | 254,800          | 6.52       | 21                     | 83,200           | 1.92       |
| Theft of assets                                | 44                     | 456,200          | 11.68      | 286                    | 486,800          | 11.21      |
| Exploiting assets                              | 86                     | 64,800           | 1.66       | 139                    | 2,711,300        | 62.43      |
| Procurement fraud                              | 33                     | 324,700          | 8.31       | 13                     | 84,200           | 1.94       |
| Personnel mgmt related fraud                   | 161                    | 5,500            | 0.14       | 64                     | 28,600           | 0.66       |
| Fraud related to payments                      | 160                    | 757,500          | 19.39      | 163                    | 539,700          | 12.43      |
| Income related fraud                           | 17                     | 2,009,400        | 51.43      | 46                     | 225,700          | 5.2        |
| Other  | 49                     | 5,600            | 0.14       | 24                     | 1,000            | 0.02       |
| Not known                                      |                        |                  |            | 66                     | 94,700           | 2.18       |
| <b>Totals</b>                                  | <b>630</b>             | <b>3,907,000</b> | <b>100</b> | <b>898</b>             | <b>4,342,700</b> | <b>100</b> |

It is important to note that there was one fraud in 2003-04 with a value of £2,000,000.

This fraud involved collusion by three department employees and 11 members of the public. Funds due the government were not collected due to this collusion.

#### **7.3.6 Queensland, Australia**

The Auditor General is informed of misconduct of officers of departments and statutory bodies and may report on this information. *The Financial Administration and Audit Act of 1977*, Section 99 requires that the Auditor General Report on each audit performed on a public sector entity. This section further indicates that the report

of the Auditor General must “draw attention to any case in which the functions relating to the financial management of the public sector entity were not adequately and properly performed if, in the auditor-general's opinion, the matter is of sufficient significance to require inclusion in the report”.<sup>38</sup>

The Auditor General has repeatedly provided updates on one major fraud case in Australia. An employee with the Port of Brisbane Corporation, a Crown Corporation, was convicted of misappropriating \$4.5 million through fraudulently altering directions to the bank on investment documents. This employee was sentenced to ten years in prison. The Auditor General also regularly reports on fraud instances discovered in aboriginal councils due to the high number of incidents in this area.

## **7.4 Summary and Recommendations**

### **7.4.1 Canada**

In Canada, although there are requirements in existence in many provinces for the reporting of losses due to illegal acts by employees, there appears to be inadequate information provided by government departments and agencies to the provincial governments. Excellent examples of these inadequacies can be seen from the information provided by Manitoba, Saskatchewan and the Yukon. Combined, these three jurisdictions received reports of losses due to illegal acts by employees totaling \$270,270 over a four-year period.

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<sup>38</sup> Queensland, Australia – Financial Administration and Audit Act 1977, Section 99

The 2004 CFE Report to the Nation indicates that their survey on occupational fraud estimates that resulted in the median loss due to fraud for governments was \$45,000.<sup>39</sup> Saskatchewan's total reported loss amount for a five-year period was \$8,686. The total revenue for the Saskatchewan government for the five-year period ended March 31, 2004 was approximately \$31.7 billion.<sup>40</sup> It is obvious, with such a small amount being reported, that the departments and agencies in Saskatchewan are not adequately reporting all losses due to fraud and other illegal acts.

Canadian governments should ensure that all losses that occur in departments and agencies are reported. Methods should be implemented to ensure that all employees are aware of their requirements to report losses due to fraud and theft. Departments and agencies should be contacted on an annual basis to ensure they are aware of the reporting requirement and that all reports have been made. It is practically impossible for a government to ensure that all departments and agencies are reporting all losses. However, taking the extra step of having a department head indicate in a written document that he or she is aware of the reporting policy and has complied with it will provide the government with some avenues of reprimand should a non-reported fraud be discovered.

The Canadian governments should report losses and the cause of the loss to the taxpayers each year. This information provides accountability to the taxpayers as to how their tax dollars are being used or misused. This information can also be

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<sup>39</sup> ACFE 2004 Report to the Nation on Occupational Fraud and Abuse, Page 7.

beneficial to governments if details can be provided as to what the government is doing about the losses. Governments will be more credible if they can show that they were victimized by the crimes and pursued all avenues for the recovery of the public funds.

#### **7.4.2 United States and Other Jurisdictions**

In the United States, the internal reporting received and the information provided to the public varies from state to state. States such as California, Washington, Mississippi and Texas provide detailed information to the public. The reports of these states provide details of the incident, how much was lost and how much was recovered. There is an emphasis placed on recovery in state governments. Texas and Mississippi go so far as to provide names of the convicted individuals in their reports. Some other states such as Pennsylvania and Nebraska provide summary information.

There are still many U.S. state governments that do not currently report losses due to illegal acts to the public. These states should consider reporting at least minimal information to the public. Reporting to the public holds the government accountable to the taxpayer for public funds and encourages transparency.

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<sup>40</sup> Saskatchewan Department of Finance, *Public Accounts*, 1999/2000 to 2003/2004. Retrieved from <http://www.gov.sk.ca/finance/paccts/default.htm> on June 1, 2005.

## **8.0 Mechanisms to Facilitate Reporting**

There are essentially three ways that a government can accept information from its employees about potential illegal acts: telephone, web-based form (including e-mail) and written communication.

Written communication is the most common method of reporting illegal acts because all governments in all jurisdictions will accept written communication from citizens. Auditor General's Offices across Canada receive hundreds of complaints from citizens each year. Although the Auditor General typically has investigative powers, the mandate of the Auditor General is legislative audit and as a result in many provinces, most of these incidents are not investigated.

According to the "ACFE 2004 Report to the Nation on Occupational Fraud and Abuse", 48.5% of all fraud in government agencies are detected through a tip.<sup>41</sup> Appendix 1 indicates that 29 state governments have dedicated hotlines for fraud reporting. The Government Accountability Office (GAO) for the U.S. Federal government is responsible for operating a system known as FraudNet. Information provided through FraudNet may be anonymous and through e-mail – the OSC only accepts written complaints. The GAO operates FraudNet as an information collection system. The GAO does not investigate the disclosures made and refers the majority of them to the appropriate department's Inspector General Office. An individual accepting these phone calls will ask questions of the caller and ensure all pertinent

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<sup>41</sup> ACFE 2004 Report to the Nation on Occupational Fraud and Abuse, p. 24.

information is recorded. Some states allow callers to remain anonymous, while other states will not accept anonymous tips. Canadian governments have been slow to adopt fraud reporting hotlines. Currently, there are no such hotlines in either the federal or provincial governments.

Many of the state government entities that accept fraud information through telephone hotlines accept email complaints as well. The Legislative Auditor for Montana provides a good example of email reporting. By clicking on a link on its fraud reporting website, an email message will open with which the reporter can report information. The site indicates:

*“When filing a complaint, please provide the following information:*

- *Your name, work and/or home telephone number, and address. You may remain anonymous; however it is quite possible that we will need to ask you further questions.*
- *Who? Who is involved, who knows about it, who can corroborate? Please provide job titles, names, telephone numbers, and addresses when possible.*
- *What? What specifically did the suspect do?*
- *Where? Which department, which division, which location?*
- *When? Frequency, ongoing, exactly when?*
- *Why? Motives?*
- *How? Lack of controls, collusion, other?*
- *What kind of documents would contain evidence? Where are they located? Who controls the documents?”<sup>42</sup>*

Some states offer a web-based reporting form onto which specific information can be entered. Exhibit 8.0 presents a portion of the form that is offered by the State of Oregon. The advantage of this form is that it ensures that all pertinent information is

collected and directed to the appropriate government department or agency that will be responsible for investigating the incident.

### Exhibit 8.0<sup>43</sup> Web-Based Fraud Reporting Form – Oregon

Please identify the individual(s) involved in the issue being reported:

(e.g. John Doe, Supervisor)

Are any of the individuals named above members of management?

Is management aware of this matter?

Please provide the specific or approximate time this incident occurred.

(e.g. 1/1/04, yesterday morning, etc.)

For how long has this situation existed?

(e.g. one day, one week, one month, etc.)

If you have reported this matter to anyone in management, please provide the name(s) of the individuals to whom you reported. Also, detail the outcome(s) of the report(s) you made.

## 8.1 Summary and Recommendations

Many U.S. State governments provide employees and the public with several methods of reporting incidents of fraud to the agency that is responsible for collecting this information. It does not take a great deal of effort for an individual to make a report as the reporting information is conveniently presented on the appropriate website.

<sup>42</sup> State of Montana Legislative Audit Division, fraud reporting page.  
<http://leg.state.mt.us/css/audit/fraudrpt.asp>

Canadian governments have not yet implemented convenient methods to allow the reporting of fraud and theft. Employees wishing to report an incident will usually be required to report it to his or her department head or to write a letter to the Auditor General. This method of reporting does not provide the confidentiality required for an employee to feel comfortable in coming forward with fraud allegations.

All governments should ensure methods are implemented which will allow employees and the general public to report illegal acts by government employees as well as other incidents of wrongdoing which cause public money or assets to be at risk. Individuals must be assured that any information they provide through these means will be collected, processed and investigated while keeping the source of the information confidential. Individuals must also be assured that, in the event the source of the information is discovered, they are protected from retaliation. The next section discusses this topic in detail.

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<sup>43</sup> State of Oregon, Online Fraud Reporting. <http://162.83.94.49/orereporting/welcome.asp>

## **9.0 Protection from Retaliation**

Governments in many jurisdictions, especially the United States, have enacted legislation to protect employees from retaliation by their employer for reporting illegal acts. Appendix 1 indicates that 40 U.S. states have enacted some type of whistleblower legislation. This legislation requires that the identifying information of government employees be kept confidential by the department or agency charged with collecting the information. The legislation also protects these employees against retaliation should identifying information be inadvertently made public.

### **9.1 Canada**

Canadian governments are slowly recognizing the need for whistleblower legislation. In September 2004, Nova Scotia enacted whistleblower protection and in doing so has become the first provincial government to have such legislation. This legislation is included as a regulation to Section 45 of *The Civil Service Act* and states that “no person shall take a reprisal against an employee”<sup>44</sup> when that employee has made a disclosure of wrongdoing. The Regulation also lists four measures that would be considered reprisal if taken against an employee.

Discussion with a representative of Nova Scotia’s Public Service Commission (PSC) of Nova Scotia has determined that in the short period of time that the Regulation has been in effect, there has been very limited usage of it. The PSC is reluctant to discuss any details of the usage of the Regulation due to confidentiality factors. The

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<sup>44</sup> Government of Nova Scotia, *Civil Service Act – Regulation – Civil Service Disclosure of Wrongdoing*, Sec 3(2). Retrieved from <http://www.gov.ns.ca/just/regulations/regs/cswrong.htm> On June 2, 2005.

Regulation requires that “*the Commissioner must report annually to the Minister responsible for the Public Service Commission respecting the disclosures of wrongdoing made during the fiscal year.*”<sup>45</sup>

In October 2004 the Canadian Government tabled Bill C-11, *The Public Servants Disclosure Protection Act* which will provide protection against reprisal for disclosing wrongdoing to federal government employees. At the time of this writing, this bill has only had its first reading in the House of Commons.

## **9.2 United States**

Federal U.S. government employees are protected from reprisal by *The Whistleblower Act of 1989*. The Office of the Special Counsel (OSC) operates a Disclosure Unit where information is accepted from employees, past employees and applicants for federal employment. The Act guarantees the confidentiality of the person making the disclosure and, as such, does not accept anonymous disclosures. The OSC does not have the authority to investigate disclosures, only to determine whether it is likely or not that a violation of a law was committed. The OSC presents a report to the applicable department, who then makes the decision on how to proceed. All government departments in the United States have an Inspector General’s Office. It is this office that conducts the investigations into incident at the request of the affected department.

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<sup>45</sup> Government of Nova Scotia, Sec 17(1)

Three examples of whistleblower legislation at the state government level are *The California Whistleblower Protection Act*, *The Alabama State Employees Protection Act* and a “Texas Government Code” section prohibiting employer retaliation.

### **9.2.1 California**

*The California Whistleblower Protection Act* provides that the State Auditor may investigate any specific information received indicating improper governmental activity of an employee or agency. “*The identity of the person providing the information that initiated the investigative audit shall not be disclosed without written permission of the person.*”<sup>46</sup> This Act also states that:

*“an employee may not directly or indirectly use or attempt to use the official authority or influence of the employee for the purpose of intimidating, threatening, coercing, commanding, or attempting to intimidate, threaten, coerce, or command any person for the purpose of interfering with the rights conferred pursuant to this article.”*<sup>47</sup>

The legislative intent of the Act is that “*state employees should be free to report... violation of law... without fear of retribution.*”<sup>48</sup>

### **9.2.2 Texas**

Texas state employees are required by law to report all incidents of fraud to the Texas State Auditor. Employees complying with this legislated reporting requirement are protected by “Texas Government Code” Section 554 “Retaliation Prohibited for Reporting Violation of Law”. This Code states:

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<sup>46</sup> Government of California, *California Government Code* Section 8547.5 Retrieved from <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=gov&group=08001-09000&file=8547-8547.12> on May 29, 2005.

<sup>47</sup> *California Government Code*, Section 8547.3

<sup>48</sup> *California Government Code*, Section 8547.1

*“a state or local governmental entity may not suspend or terminate the employment of, or take other adverse personnel action against, a public employee who in good faith reports a violation of law by the employing governmental entity or another public employee to an appropriate law enforcement authority.”<sup>49</sup>*

States offering whistleblower or employee protection legislation receive thousands of calls each year with only a small portion of the calls warranting investigation.

Whistleblowing complaints are wide ranging, they include complaints about state employees running personal errands with government vehicles or on government time to theft and fraud amounting to thousands of public dollars.

### **9.2.3 Washington**

Washington has also enacted whistleblower legislation, *The Whistleblower Act* (Revised Code of Washington Chapter 42.40). The intent of this Act *“is to encourage state employees to report improper governmental action(s). The law makes retaliation against whistleblowers unlawful and authorizes remedies should it occur.”<sup>50</sup>* The Whistleblower Program is operated by the State Auditor’s Office. Employees are not required to report illegal acts, however, the Program facilitates reporting for those employees wishing to report improper governmental action and protects those employees who do. Table 9.2.3 summarizes the Whistleblower Program for Washington for the years 2000 – 2004<sup>51</sup>. It is important to note that the Whistleblower reports and the Fraud reports from the Washington State Auditor’s Office are not related. Whistleblower allegations are investigated and reported on

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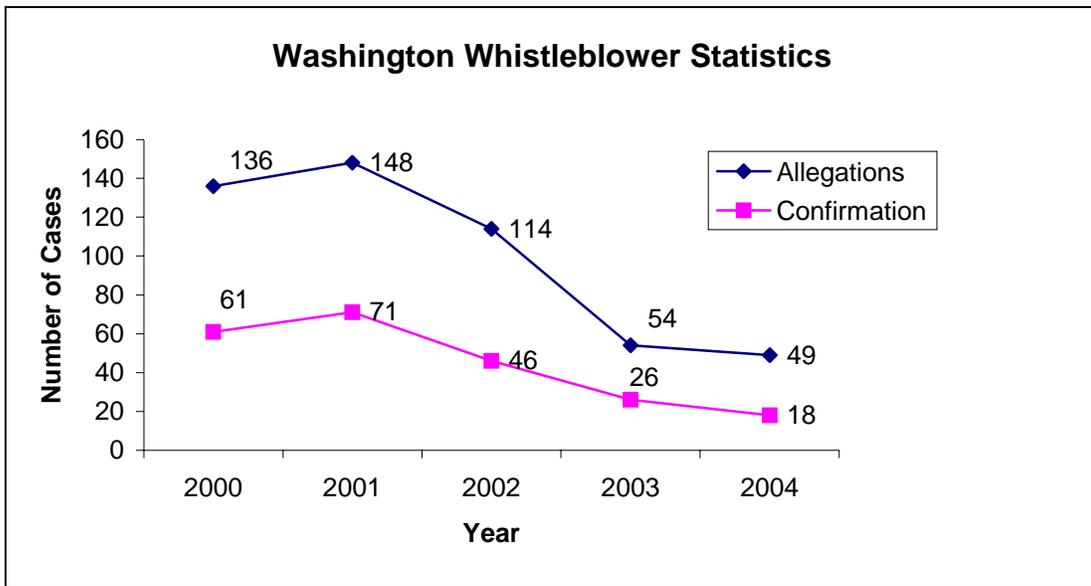
<sup>49</sup> Government of Texas, *Texas Government Code*, Section 554.002(a). retrieved from [Texas Government Code Section 554](#) on June 1, 2005

<sup>50</sup> Washington State Auditor’s Office, Whistleblower Program. <http://www.sao.wa.gov/Whistleblower/index.htm>

separately from fraud incidents. Whistleblower incidents are primarily focused on improper acts by government employees and these include many more types of incidents than fraud. Examples of the incidents reported under the Whistleblower Program include:

- employees using state computers for personal business
- a state employee using assistants to baby-sit children
- overtime approval to attend a non-work related event
- use of state owned telephones for personal business

**Table 9.2.3**



There were a total of 501 allegations made to the State Auditor through the Whistleblower Program between 2000 and 2004. All allegations are investigated and reported to the public. Of the 501 allegations that were made, 222 were substantiated through State Auditor Investigation. These investigations resulted in the State Auditor

<sup>51</sup> This information is compiled from the Washington State Auditor's *Whistleblower Investigation Reports*. Retrieved from <http://www.sao.wa.gov/Whistleblower/WBReports/WhistleblowerReportsPage.htm> on May 29, 2005

recommending that \$375,578 be recovered from the state employees or agencies acting improperly.

#### **9.2.4 Summary and Recommendations**

It is important to promote reporting of fraud and other improper actions through whistleblower legislation or other methods; however it is also important to consider the costs of running such a program versus its benefits. A whistleblower program will only be beneficial to a government if its benefits (recoveries) outweigh its costs. Washington does not provide details as to the costs of running the Whistleblower Program. As indicated above, 501 allegations were investigated resulting in a recommendation to recover a total of \$375,578. Assuming that this amount was recovered in its entirety, the amount recovered per investigation is \$749. Other benefits of the Program cannot be quantified such as provide taxpayers with assurance that government employees and agencies are being held accountable in cases of fraud or wrongful acts. The program would not be beneficial if investigative costs exceed these benefits.

Forty U.S. State governments have enacted a type of whistleblower legislation to protect employees against retaliation by the government department or agency they are employed by. This protection prevents a department or agency from enacting any type of employment related retaliation or sanction against the employee for reporting illegal acts occurring within the department or agency. Canadian governments have

been slow to follow the U.S. Governments in this respect. Currently, only the Nova Scotia government has enacted this type of legislation

Although outside the scope of this paper, Qui Tam provisions are used by the United States federal government in *The False Claims Act*, with respect to fraudulent claims against the government by contractors. This provision allows the whistleblower to receive a certain percentage of funds recovered by the government as a result of the whistleblowers information. Governments may wish to consider adopting a similar provision in their whistleblower legislation for the protection of employees. This will provide employees with even more incentive to voluntarily report fraud.

Governments that expect an employee's assistance with respect to reporting cases of fraud, theft and other illegal acts against public property should make every effort to ensure these employees are protected against retaliation by their employer.

Whistleblowing legislation is an essential component of any program to emphasize and promote the reporting of illegal acts by government employees.

## **10.0 Effectiveness of Reporting**

The Merriam-Webster on-line dictionary defines effective as “producing a decided, decisive or desired effect.”<sup>52</sup> To determine the effectiveness of policies and legislation that have been put in place to require the reporting of losses of public monies due to illegal acts, we must first define criteria of effectiveness. In order for these policies or legislation to be considered effective they must achieve deterrence, detection and education. Employees should be deterred from committing fraud and theft from the outset. The deterrent factor is usually achieved through strict enforcement policies, ensuring that all frauds and thefts are prosecuted.

The requirements for fraud reporting implemented by governments should lead to increased detection of frauds and thefts. If employees are now required to report all frauds and thefts that they are aware of, the number of actual frauds and thefts reported should increase. This does not mean that more frauds and thefts are occurring but rather that more are being reported to comply with the new requirements. In approximately 1997 the State of Texas enacted legislation that requires employees to report all known incidents of fraud to the State Auditor’s Office (SAO). Through an interview with employees of the investigation unit of the SAO it was discussed as to the impact this legislation has had on detection of fraud. It is the opinion of the SAO that this legislation has resulted in an increase of reported incidents; however, figures to support this opinion could not be provided.

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<sup>52</sup> Merriam-Webster definition from <http://www.m-w.com/cgi-bin/dictionary?book=Dictionary&va=effective&x=14&y=23> on June 15, 2005.

Appropriate training programs should be offered to management to educate them about fraud and theft. Managers who learn about fraud and theft, how it occurs, who commits it, and red flags to look for will be more likely to detect fraud. When employees are made aware that management has been trained in the area of detecting fraud, this too will be a deterring factor. Educated management results in a more risky environment to commit fraud and theft.

The act of passing legislation that requires the reporting of losses, as has been done in 14 U.S. States (Appendix 1), could be inspired either by a lack of information or it could be a reaction to an event where illegal acts resulted in losses. In such an event, it would become apparent that more reporting and accountability is needed, which would lead to the drafting of legislation. The desired effect of administrative policies and legislation requiring that government departments report losses is accountability and transparency. Inherent in most policies and legislation is the requirement to report on how internal controls were breached as well as the steps taken to ensure that the incident could not reoccur. Departments and Agencies must explain why the controls that were implemented were not effective in preventing the incident. This holds departments and agencies accountable to taxpayers, forcing an explanation of how and why losses occurred and what the department or agency is doing to improve controls to protect taxpayers' money. Losses due to illegal acts are inevitable. There is no system of internal controls that can prevent all losses. Taxpayers should be provided with information that gives them a complete picture of how their money is being used, including funds that have been misappropriated or lost.

It is questionable how effective a policy or law can be when no punishment results from non-compliance. Very few governments have incorporated a punishment into the legislation requiring reporting of losses. Discussions with several State Auditor's Offices revealed that non-reporting when required to would result in a reportable audit finding. A negative comment in the State Auditor's Report does not have the same effect as being charged with a Class A misdemeanor, which is the penalty for non-reporting in Texas.

Provincial Governments in Canada have been reluctant to enact legislation that requires the reporting of losses. At least nine provinces have internal policies that require losses be reported to the Department of Finance. Internal policies do not have the same requirement level as legislation would. Non-reporting of information required under legislation constitutes breaking the law and would likely result in a fine or some other sort of punishment. An analysis of the requirements of all Canadian provincial governments shows that there is no punishment for non-reporting in any province. The funding for departments and agencies flows through the Department of Finance and it is imperative that they be kept abreast of the use, or misuse of these funds. What the Department of Finance does with the internal reports is an important step toward whether or not the policies are effective. If information is collected for knowledge purposes, so the Department of Finance knows where the funds are being utilized, the effectiveness of requiring losses to be reported would be minimized. If a punishment aspect were incorporated to hold departments and

agencies truly accountable for their losses, the effectiveness of these policies would be enhanced. Currently, losses due to illegal acts are replaced by other government funds, whether the loss was preventable or not. To increase accountability, if a punishment was added to the current policies where losses were not replaced in situations where they were preventable (due to weak or non-existent controls), departments would have to operate under an even tighter budget than current governments currently face. Further still, if departments and agencies were required to report losses on their financial statements as a separate line item, instead of hiding amounts in other expense totals, it would be transparent to the public. Large losses on a department's financial statements could result in a loss of confidence in the elected official that is responsible for that department.

The above situation provides a way to hold departments and agencies responsible for losses in situations where they should have been prevented; however, it does not address the problem of non-reporting of losses. Departments and agencies would likely not report losses if they are to be held accountable for them. This is the flaw of a policy where there is no punishment for non-compliance. As mentioned earlier, the Texas State Government has enacted legislation that requires state agencies to report losses due to illegal acts to the State Auditor. Failure to report is a Class A misdemeanor and is punishable by a fine of up to \$4,000 and up to one year imprisonment.

## **11.0 Prevention**

Prevention of fraud by government employees starts at the top of the department or agency. Department heads or agency boards are responsible for instituting controls and for making employees aware of the fact that the organization will not tolerate fraud by its employees, or anyone else. Department and agency ethics and culture should, in and of themselves, promote ethical behaviour by its employees and deter illegal acts. It is understood that the ethics and attitudes of board members and management largely influence the ethics and attitudes of the lower level employees of a department or agency. This is commonly referred to as “the tone at the top”, where employees observe the behaviour of department heads and boards, and tend to adopt the same behaviour. Management that sets an example of ethical behaviour and implements strict, but not too strict, policies as to what behaviour is expected of employees will likely oversee employees that are ethical and loyal. Ultimately it is the department head or the board’s task to ensure adequate policies are in place to promote ethical behaviour. It is also the responsibility of the department head or the agency board to ensure that appropriate internal controls are in place to deter and detect potential fraudulent activities by employees.

A report issued by the Australian National Audit Office (NAO) entitled “Fraud Control in Australian Government Agencies” indicates that government departments and agencies should have a fraud policy in place which covers the following:

- “the definition of fraud;
- an outline of the agency’s position on fraud;
- the protection of revenue and information;
- its commitment to investigating and prosecuting fraud;

- a list of employee responsibilities relating to the prevention and reporting of fraud, and the means of reporting fraud;
- the assistance employees are to provide in fraud investigations;
- assurance that allegations and investigations will be handled confidentially; and
- advice on where further information can be found.”<sup>53</sup>

It is important that employees know the repercussions of fraudulent activities against their employer. When employees witness their colleagues being prosecuted for fraud and theft crimes against their employer, future incidents of these crimes by employees will be deterred. Many Canadian governments are passive in the area of prosecution of employees except in circumstances that are made public by media outlets.

Information was provided about one province where in excess of \$1,000,000 was over 2 or 3 years. When this incident was discovered and the employee confronted, his resignation was accepted by the government, with no further prosecutorial action taken. The bonding company reimbursed \$500,000 of this loss. This government is now in the process of trying to find another bond company as the prior bond company refuses to insure them due to the lack of action by the government with respect to this incident.

It is impossible to prevent all losses due to fraud, theft and other illegal acts by employees; however governments should implement steps to ensure losses are minimized. Most governments that require departments and agencies to report losses also require, along with the amount of the loss, a report indicating steps taken to prevent similar losses in the future. A few examples of cases where controls were implemented or improved as a result of a fraud are provided here.

### **11.1 Theft of Physical Assets**

Three cases from the United Kingdom involved employee theft of physical assets.

The indicated action taken on each incident was the implementation and improvement of physical security. In one case, computers were not locked in a room or to the desks they were on. The controls implemented subsequent to this theft were the simple tasks of ensuring that during the day, the computers were locked to the desks or tables and at night, they are secured in a locked guardroom. In another case vehicles were stolen from a secure site and the indicated corrective action taken was the improvement of physical security at the site.

Physical security is a fundamental part of any internal control system and it should not require the occurrence of a theft to see the need for this control. Although the simple control of ensuring physical security of assets likely should have been in place, the fact that the step was taken subsequent to the loss will greatly reduce the likelihood that a similar incident could occur in this organization.

### **11.2 Theft of Cash**

One case from Saskatchewan and one case from the United Kingdom are discussed here to determine actions taken on cases involving the theft of cash by a government employee. The Saskatchewan case involved the theft of approximately \$5,600 from tenants' rent payments. The victimized entity was audited and it was determined that adequate controls were in place for the handling of cash. It can be argued here that if

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<sup>53</sup> Australian National Audit Office, *Fraud Control in Australian Government Agencies*, Chapter 4, pp. 1-2

adequate controls were in place, the theft would not have happened. Perhaps, from a textbook perspective, adequate controls exist. However, if the controls were breached once, additional controls should be implemented to prevent the occurrence of a similar incident.

The case from the United Kingdom resulted in the loss of £2,000,000 in revenues due to the collusion of three employees. The report of Her Majesty's Treasury indicates that this case exposed deficiencies in management procedures. The action taken as a result of this case was "to increase management control, provide more central direction, increase the number of teams included in the work rota system and restrict management information."<sup>54</sup> It is unfortunate that such a large loss was required to bring the control deficiencies to light. It is important, however, that adequate steps were taken to prevent a reoccurrence of this type of incident.

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<sup>54</sup> HM Treasury "An analysis of reported frauds in government Departments" 2003-2004

## **12.0 Opportunities for the IFA**

It is interesting that, although fraud against the government by employees costs taxpayers hundreds of thousands of dollars each year, governments employ very few forensic accountants. The Alliance for Excellence in Investigative and Forensic Accounting's 2005 Membership Directory lists seven individuals that are employed by government agencies in Canada. In researching this paper, representatives of many U.S. government agencies were interviewed. Only one agency identified that there was a forensic accountant on staff, that being the Inspector General's Office in New York. However, there are many Certified Fraud Examiners employed by both U.S. and Canadian governments and therefore these governments are not without expertise in the area of fraud.

There are several areas where an IFA can assist governments in the area of employee fraud. IFAs can be employed directly by government departments and agencies or can be hired as contractors on an as needed basis. Government departments and agencies are audited on an annual basis, either by the legislative auditor or a public accounting firm. Although financial statement auditors are increasingly being required to specifically recognize fraud risks during financial statement audits as a result of expanding requirements of the Canadian Institute of Chartered Accountants, they have historically insisted that their audit procedures are not designed to detect fraud, but may result in fraud being detected.

An IFA could be engaged to specifically look for signs of fraud or for areas where fraud risk is high. An IFA will perform work to detect fraud that will go beyond work that is typically performed as part of an annual financial statement audit. It is unreasonable to expect an IFA to perform forensic work on each department and agency annually, however it would be beneficial to governments to have an IFA perform work on a rotating basis. An IFA could perform some preliminary work on departments and agencies every five years. High-risk departments or agencies, such as those responsible for lotteries and casinos, would be worked on more frequently, with some in-depth work possibly every three years. The preliminary work would involve reviewing financial statements and internal controls for red flags for fraud. The discovery of several red flags in a department or agency could warrant that the IFA be requested to perform in-depth work in that entity.

IFAs can also be employed to investigate specific matters to supplement the government's resources which may not be able to investigate all matters that should be investigated. IFAs can also provide educational services to improve the government's abilities to identify inappropriate activities. IFAs can assist either directly within government departments, or in government departments having oversight responsibilities such as the Auditor General, various regulatory agencies, or enforcement agencies such as the police.

### **13.0 Conclusion**

Fraud, theft and other illegal acts against the government by its employees costs taxpayers millions of dollars each year. Governments should ensure that an adequate process is in place to ensure that all frauds and thefts are reported. A government's best chance of combating and detecting these illegal activities is from the reporting of these incidents by other employees. Governments should provide their employees with a convenient and confidential method for the reporting of these incidents to the proper authorities. Confidential hotlines are an excellent way to promote this reporting. Currently there are no confidential hotlines in Canada, while 29 U.S. state governments have implemented hotlines. In return for reporting these incidents, governments should ensure these employees are protected with some type of whistleblower legislation. U.S. governments are far more progressive in this area than the Canadian governments, with 40 state governments and the U.S. federal government having enacted whistleblower legislation. In Canada, only Nova Scotia has enacted a whistleblower provision.

The public reporting of losses of public funds due to illegal acts by employees is inconsistent among the U.S. and Canadian governments. Typically, Canadian governments do not report instances of fraud and theft against public funds to the general public. The reasons presented for this were most often fear of embarrassment or bad publicity. Government agencies and departments should be accountable for the public funds they are apportioned. The elected politicians have the ultimate oversight and responsibility for these public funds. The best way to hold a department or

agency accountable is to make information public and let the taxpayers decide with their next vote.

# Appendix 1

## A1.0 Survey Results – United States

| State          | Reporting Requirement | Whistleblower | Hotline |
|----------------|-----------------------|---------------|---------|
| Alabama        |                       | Y             | Y       |
| Alaska         |                       | Y             |         |
| Arizona        |                       | Y             |         |
| Arkansas       |                       |               |         |
| California     | Y                     | Y             | Y       |
| Colorado       |                       | Y             |         |
| Connecticut    | Y                     | Y             | Y       |
| Delaware       |                       | Y             | Y       |
| Florida        |                       | Y             |         |
| Georgia        | Y                     |               |         |
| Hawai'i        |                       | Y             |         |
| Idaho          |                       | Y             |         |
| Illinois       |                       | Y             | Y       |
| Indiana        |                       | Y             | Y       |
| Iowa           |                       | Y             |         |
| Kansas         |                       | Y             |         |
| Kentucky       |                       | Y             | Y       |
| Louisiana      | Y                     | Y             | Y       |
| Maine          | Y                     | Y             |         |
| Maryland       | Y                     | Y             |         |
| Massachusetts  |                       | Y             | Y       |
| Michigan       |                       | Y             |         |
| Minnesota      | Y                     | Y             | Y       |
| Mississippi    | Y                     | Y             | Y       |
| Missouri       |                       | Y             | Y       |
| Montana        | Y                     | Y             | Y       |
| Nebraska       |                       | Y             | Y       |
| Nevada         |                       | Y             |         |
| New Hampshire  |                       | Y             |         |
| New Jersey     |                       |               | Y       |
| New Mexico     | Y                     | Y             | Y       |
| New York       | Y                     | Y             | Y       |
| North Carolina | Y                     | Y             | Y       |
| North Dakota   |                       | Y             |         |
| Ohio           |                       |               | Y       |
| Oklahoma       |                       | Y             |         |
| Oregon         |                       | Y             | Y       |
| Pennsylvania   |                       | Y             | Y       |
| Rhode Island   |                       |               | Y       |
| South Carolina |                       |               | Y       |
| South Dakota   |                       |               |         |
| Tennessee      |                       |               | Y       |
| Texas          | Y                     | Y             | Y       |
| Utah           |                       | Y             | Y       |
| Vermont        |                       |               | Y       |
| Virginia       |                       | Y             | Y       |
| Washington     | Y                     | Y             | Y       |
| West Virginia  |                       | Y             |         |
| Wisconsin      |                       | Y             |         |
| Wyoming        |                       |               |         |

|  |    |
|--|----|
| States with Legislation Requiring Reporting  | 14 |
| States with Whistleblower Legislation        | 40 |
| States with a Fraud, Waste and Abuse Hotline | 29 |

### **A1.1 Survey Method and Results**

An e-mail was sent to an individual in the State or Legislative Auditor's Office in each state. The e-mail asked the following questions:

1. Does the state have legislation or a policy that requires the reporting of fraud by state employees?
2. Does the state have whistleblower legislation in effect?
3. Does the state operate a hotline which allows for the reporting of fraud, waste and abuse?

The results of the survey were moderate, with 32 of 50 (64%) states responding to the e-mail. Non-responses were followed up through an in-depth search of state legislation via state legislature websites. As a result, the table above is complete.

The column indicating whether or not a hotline exists for a specific state is based on whether or not an individual could reasonably be expected to locate the hotline without too much difficulty. The hotline information is usually presented on the websites of one of the following agencies:

- State Auditor
- Legislative Auditor

- Attorney General
- Inspector General
- Secretary of State

## Appendix 2

### A2.0 Survey results - Canada

| Fraud Reporting Requirements<br>For Provincial Government Departments |              |  |
|---|--------------|--|
| Province  | Requirement  | Reportee   |
| British Columbia  | Yes          | Executive Financial Officer  |
| Alberta   | Yes          | Special Prosecutions Branch  |
| Saskatchewan  | Yes          | Provincial Comptroller   |
| Manitoba  | Yes          | Provincial Comptroller<br>Auditor General                          |
| Ontario   | Not Required |  |
| Quebec  | No Response  |  |
| New Brunswick   | Yes          | Deputy Head of Department<br>Deputy Minister of Provincial Affairs |
| Prince Edward Island  | Yes          | Attorney General   |
| Nova Scotia   | Yes          | Department of Finance<br>Auditor General                           |
| Newfoundland and Labrador   | Not Required |  |
| Yukon   | Yes          | Deputy Minister of Finance   |
| Northwest Territories   | Yes          | Comptroller General  |
| Nunavut   | No Response  |  |

### A2.1 Survey Method and Results

The Department of Finance for each province was contacted by telephone and asked the following question:

Does the province have a requirement to report fraud or other illegal acts, either legislated or through a policy?

11 of the 13 provincial and territorial governments responded to this survey. Quebec and Nunavut were the two non-respondents.

9 of the 11 responding governments have a policy in effect for the reporting of fraud.

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