REPORT TO AUDIT COMMITTEE

915 I Street, Sacramento, CA 95814-2604
www.CityofSacramento.org

Staff Report
February 14, 2012

Honorable Members of the Audit Committee

Title: Assessment for Establishing a Whistleblower Hotline

Location/Council District: Citywide

Recommendation: Accept the Auditor's *Assessment for Establishing a Whistleblower Hotline* and forward to the City Council for final approval.

Contact: Jorge Oseguera, City Auditor 808-7270

Presenters: Jorge Oseguera

Department: Mayor and City Council

Division: Office of the City Auditor

Organization No: 01001201

Description/Analysis

Issue: This audit was approved as part of the 2011-12 Audit Plan. According to City Code Chapter 2.18, the City Council should be kept apprised of the City Auditor's work. The Audit Committee shall receive, review, and forward to the full Council the City Auditor's updates and reports.

Policy Considerations: The City Auditor's presentation of the *Assessment for Establishing a Whistleblower Hotline* is consistent with the Mayor and City Council's intent to have an independent audit function for the City of Sacramento.

Environmental Considerations: None.

Sustainability Considerations: None.

Rationale for Recommendation: The *Assessment for Establishing a Whistleblower Hotline* was approved as part of the Auditor's 2011-12 Audit Plan. The report includes one finding and four recommendations.

Financial Considerations: The costs of performing this audit were funded out of the 2011-12 Office of the City Auditor Budget.

Emerging Small Business Development (ESBD): No goods or services are being purchased as a result of this report.

Respectfully Submitted by: _____
Jorge Oseguera, City Auditor

Table of Contents:

Report pg. 1

Attachments

1 Attachment 1 – *Assessment for Establishing a Whistleblower Hotline* pg. 3

Report # 2012-01

Attachment 1

Assessment for Establishing a Whistleblower Hotline:

Establishing a whistleblower hotline could benefit the City by empowering employees to report fraud, waste, and abuse

- A whistleblower hotline can be an effective tool for detecting and preventing costly incidents of fraud, waste, and abuse
- Many City employees surveyed have encountered possible fraud, waste, or abuse
- State law sets requirements for establishing and running a whistleblower hotline, but local auditors have discretion in how to operate their programs
- California cities run whistleblower hotlines differently, but have similar goals
- Establishing and running a whistleblower hotline in Sacramento could cost more than $200,000 per year, but could yield larger benefits

Jorge Oseguera
City Auditor

Scott Herbstman
Auditor

Office of the City Auditor
February, 2012

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CITY OF SACRAMENTO
CALIFORNIA

Office of the City Auditor
Jorge Oseguera, City Auditor

February 14, 2012

Honorable Mayor and
Members of the City Council
915 I Street - Fifth Floor, New City Hall
Sacramento, CA 95814-2604

Enclosed is the *Assessment for Establishing a Whistleblower Hotline*. We conducted this audit in accordance with generally accepted government auditing standards and City Code Chapter 2.18.

The report contains one finding and makes four recommendations for moving towards establishing a City Whistleblower Hotline. I will present this audit at the February 14, 2012 *Audit Committee* meeting.

We would like to thank the City Attorney's Office for their assistance and cooperation during this audit.

Should you have any questions, please feel free to contact me.

Respectfully submitted,

Jorge Oseguera
City Auditor

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Contents

Executive Summary 3

Introduction 4

Background 4

Audit Objective, Scope, and Methodology 5

Finding I: Establishing a whistleblower hotline could benefit the City by empowering employees to report fraud, waste and abuse 6

A whistleblower hotline can be an effective tool for detecting and preventing costly incidents of fraud, waste, and abuse 6

Many City employees surveyed have encountered possible fraud, waste, or abuse 7

State law sets requirements for establishing and running a whistleblower hotline, but local auditors have discretion in how to operate their programs 11

California cities run whistleblower hotlines differently, but have similar goals 13

Establishing and running a whistleblower hotline in Sacramento could cost more than $200,000 per year, but could yield larger benefits 15

RECOMMENDATIONS 18

Executive Summary:

According to the Association of Certified Fraud Examiners' (ACFE) 2010 *Report to the Nations on Occupational Fraud and Abuse*, a typical organization is estimated to lose 5 percent of its annual revenues to fraud. The ACFE defines occupational fraud as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."

The ACFE recommends that employers set up whistleblower hotlines to allow employees to anonymously report possible fraud. The City of Sacramento does not have a whistleblower hotline. However, other large cities in California have hotlines that allow for anonymous reporting of fraud, waste, and abuse. Some California cities with whistleblower hotlines are Long Beach, Los Angeles, Oakland, San Diego, and San Francisco. In 2009, State law went into effect that enabled local government auditors to establish whistleblower hotlines and to provide whistleblower protections.

Establishing a whistleblower hotline could benefit the City by empowering employees to report fraud, waste, and abuse

If City losses due to fraud were in line with ACFE estimates for a typical organization, the loss to the General and enterprise funds would equal about $30.3 million per year. The City's actual loss from fraud is unknown. However, the ACFE study found that receiving tips is the most frequent way fraud is detected, and that the cost and duration of fraud activity was less in organizations with whistleblower hotlines.

We surveyed City employees anonymously to seek their views on establishing a hotline and the ethical climate of the City. Over 580 employees responded to the survey. Given the responses, there appears to be strong interest and support for establishing a whistleblower hotline. Many employees indicated having observed instances of fraud, waste, or abuse.

We estimate that establishing a City whistleblower hotline could cost more than $200,000 per year, but could yield larger benefits. Costs would primarily be related to additional personnel. We estimate that running a hotline with the current Office of the City Auditor's staff would cost about $15,000 per year, but would reduce the number of performance audits that could be completed and limit the timely response to whistleblower complaints.

The following are the report recommendations to City Council:

1. Provide the City Auditor direction regarding establishing a City whistleblower hotline in Fiscal Year 2012-13.
2. If Council supports establishing a hotline, direct management to identify a funding source.
3. If Council supports establishing a hotline, direct the City Attorney's Office to draft a whistleblower resolution and non-retaliation resolution for adoption by Council.
4. Direct the City Attorney and City Manager to establish a Citywide Code of Ethics.

Introduction

In accordance with the City Auditor's 2011-12 Audit Plan, we have completed an *Assessment for Establishing a Whistleblower Hotline.* We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

According to the Association of Certified Fraud Examiners' (ACFE) 2010 *Report to the Nations on Occupational Fraud and Abuse*, a typical organization is estimated to lose 5 percent of its annual revenues to fraud. The ACFE defines occupational fraud as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets." The study found that governments were especially vulnerable to employees committing fraud and were the third most commonly victimized industry of the 22 reviewed.

The ACFE recommends that employers set up whistleblower hotlines to allow employees to anonymously report possible fraud since more than one third of discovered occupational frauds are initially detected through tips. The City of Sacramento does not have a whistleblower hotline. However, other large cities in California have hotlines that allow for anonymous reporting of fraud, waste and abuse. Some California cities with whistleblower hotlines are Long Beach, Los Angeles, Oakland, San Diego, and San Francisco.

In 2009, State law went into effect that enabled local government auditors to establish whistleblower hotlines and to provide whistleblower protections. Local auditors are authorized under California Government Code Section 53087.6 to create whistleblower hotlines with the approval of their respective legislative bodies. Other local government auditors have established whistleblower hotlines to receive complaints and to investigate potential fraud, waste, and abuse.

The California Government Code defines "fraud, waste, or abuse" in this context as an activity by a local government or employee "that is in violation of any local, state, or federal law or regulation relating to corruption, malfeasance, bribery, theft of government property, fraudulent claims, fraud, coercion, conversion, malicious prosecution, misuse of government property, or willful omission to perform duty, is economically wasteful, or involves gross misconduct."

The Government Code allows local auditors that establish whistleblower hotlines to conduct investigative audits of alleged improper government activities such as fraud, waste, and abuse. The Code protects the identity of whistleblowers as well as the identity of subjects of audit investigations, with some exceptions. Local government auditors report on investigations in different ways. Some issue detailed reports at the end of investigations while others provide brief summaries about completed investigations. In addition to reporting investigation results, some local government auditors also report out the number of complaints received.

Audit Objective, Scope, and Methodology

The objective of this audit was to study whistleblower hotline practices in general and at other California cities in order to determine possible options for creating a Sacramento City whistleblower hotline. We reviewed the California Government Code related to whistleblower hotlines, other cities' hotline information, best practices, as well as studies of fraud, waste, and abuse. Additionally, we conducted an online survey to determine Sacramento City employees' attitudes about establishing a hotline and the ethical climate of the City.

This report was not added to the Annual Audit Plan For Fiscal Year 2011-12 because of specific fraudulent activities or allegations of fraud. Instead, the item was added because of Council Members' interest in establishing a whistleblower hotline as well as recent changes to California law that set parameters for local government auditors to establish hotlines.

Finding I: Establishing a whistleblower hotline could benefit the City by empowering employees to report fraud, waste and abuse

Government employers as well as businesses and non-profits can be victims of employee fraud. According to the Fiscal Year 2011-12 Budget, the City of Sacramento has almost 4,100 full-time-equivalent positions. While most employees at the City and other organizations are likely operating within the law, a small number of employees could be committing fraudulent acts. Such acts could be costly – especially when they go undetected for long periods of time.

Whistleblower hotlines can serve as tools to detect and prevent fraud, waste, and abuse. However, there are costs associated with establishing hotlines that should be considered when planning an effective operation.

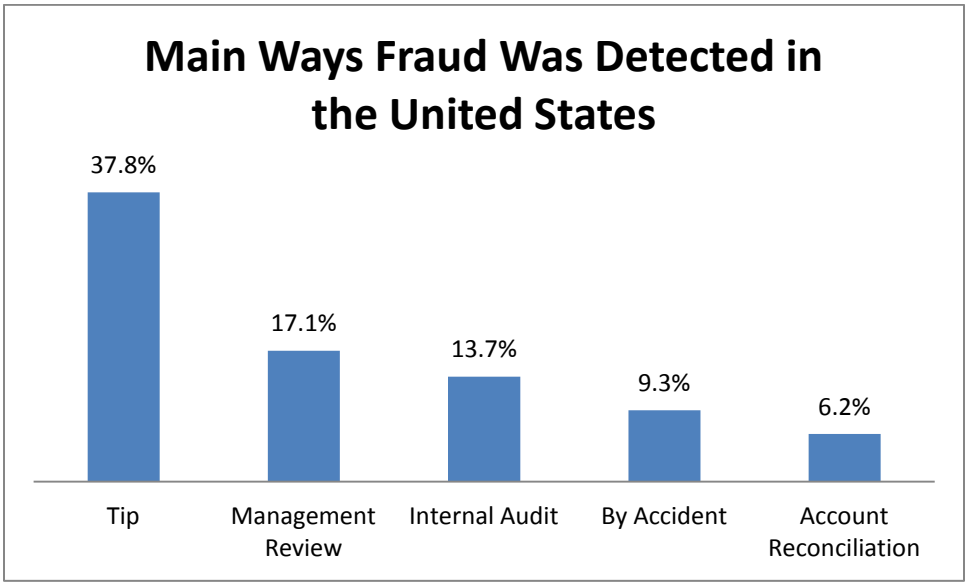
A whistleblower hotline can be an effective tool for detecting and preventing costly incidents of fraud, waste, and abuse

As noted in the Background section, the Association of Certified Fraud Examiners (ACFE) estimates that a typical organization loses 5 percent of its annual revenues to fraud. The estimate does not include loss from waste and abuse. If this 5 percent fraud loss was applied to the City of Sacramento's expected Fiscal Year 2011-12 General and enterprise funds total revenue of $606.4 million, it would equal more than $30.3 million per year.

While the above estimate is included to provide perspective, the City's loss from fraud is unknown. In general, the longer such incidents go undetected, the more costly they become.

A whistleblower hotline could be an effective tool to help detect and prevent fraud, waste, and abuse. While the ACFE found that audits, management reviews, and account reconciliations detected some instances of fraud, the most likely method of initial detection of occupational fraud was through receiving tips. The following exhibit shows survey results from the ACFE about the top five methods in which occupational fraud was detected in more than 1,000 cases studied in the United States.

Exhibit 1: More than a third of fraud was initially detected by tips[1]



Source: Association of Certified Fraud Examiners' (ACFE) 2010 *Report to the Nations on Occupational Fraud and Abuse*

The presence of hotlines correlates with an increase in the number of fraud cases detected by tips and having hotlines correlates with smaller losses. The ACFE found in its worldwide study of 1,843 cases of occupational fraud that in organizations with hotlines, 47 percent of frauds were detected by tips. For those without hotlines, just 34 percent of cases were detected through tips. The ACFE also found that when a hotline was in place, both the median loss per case and the time to detect fraud decreased. Specifically, median loss was $100,000 for organizations with hotlines and $245,000 for those without hotlines. Additionally, the duration of fraud activities was 35 percent less in cases in which organizations had hotlines.

Many City employees surveyed have encountered possible fraud, waste, or abuse

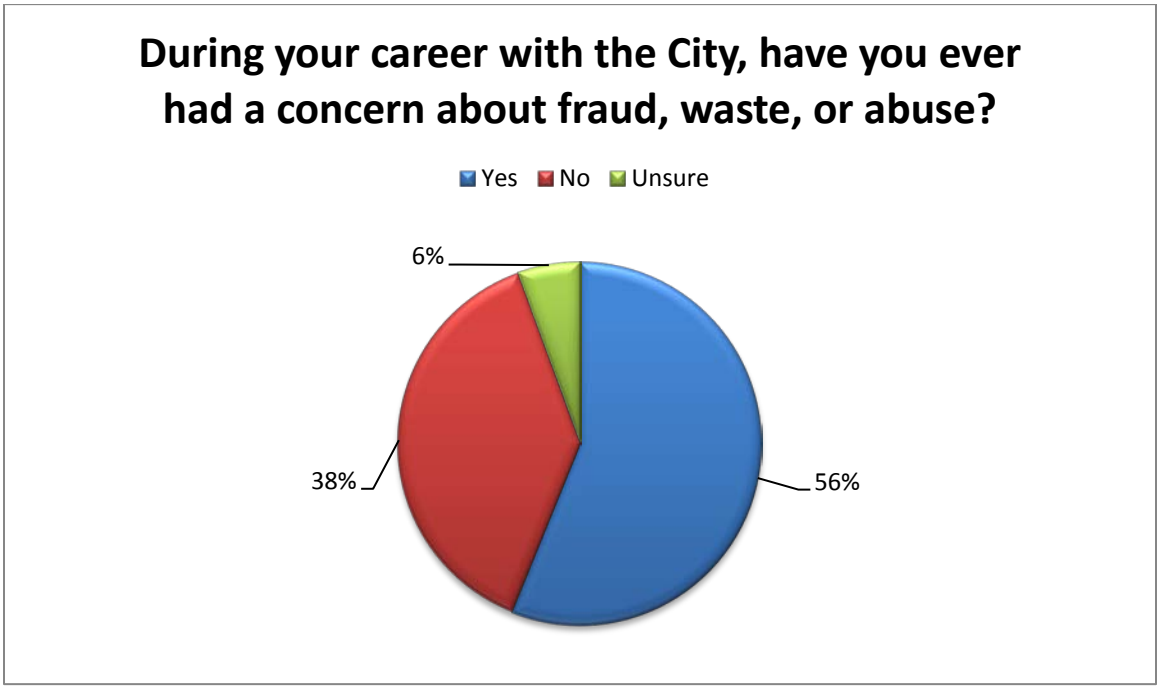
As noted above, it is difficult to estimate the current losses associated with active frauds. To better understand the possible prevalence of fraud, waste, or abuse within the City, we surveyed City employees to seek their views on establishing a whistleblower hotline and the ethical climate of the City. The survey was administered anonymously online using Survey Monkey and employees city-wide were invited to participate. The survey was open for four days from January 9 through January 12, 2012, and 581 people completed it. About 28 percent reported that they had worked for the City for less than seven years while the remaining 72 percent reported that they had worked for the City for longer than seven years.

[1] Percentages do not equal 100 percent since not all methods of detecting fraud were included.

More than half of employees had past concerns about fraud, waste, or abuse and many did not report allegations

About 56 percent, which represents 326 employees surveyed, indicated past concerns about fraud, waste, or abuse while working at the City. The following shows the percentages of those who had, did not have, or were unsure if they had concerns:

Exhibit 2: More Than Half The Employees Surveyed Had A Concern About Fraud, Waste, Or Abuse



Source: Auditor generated based on employee survey results

For those 326 employees who answered "yes," to the question noted above, the survey also asked if they had reported the concerns.[2] The most prevalent reason that employees provided for not reporting concerns was the fear of retaliation. Employees who did report most frequently informed their supervisor or manager of their concerns. All answers are shown in the following figure:

[2] Participants were allowed to select all categories that applied in a separate question, and these employees entered 513 responses.

Exhibit 3: Employees Noted A Fear Of Retaliation

Did you report the concern? Select all that apply.	Response Count
Not Reported:	
Did not report because I did not know who to report concern to	66
Did not report because of fear of retaliation	125
Did not report for other reasons	67
Reported:	
Reported to my supervisor/manager	127
Reported to another supervisor/manager	38
Reported to executive management	35
Reported to law enforcement	6
Reported to union representative	18
Reported to other	31

Source: Auditor generated based on employee survey results

More than two thirds of these employees indicated that they would have reported or considered reporting suspected fraud, waste, or abuse to a whistleblower hotline had it existed at the time. Specifically, 31 percent said they would have reported and 38 percent said they possibly would have reported. Others were unsure and about 19 percent indicated that they would not or probably would not have reported.

Our survey question regarding reporting concerns in the future indicated that 75 percent would or possibly would report information to a hotline. The following shows how the 581 employees responded:

Exhibit 4: Employees Said They Would Be Willing To Report To A Whistleblower Hotline

If you encounter City fraud, waste, or abuse in the future, would you call a Whistleblower Hotline that would allow you to provide information anonymously?		
Answer Options	**Response Percent**	**Response Count**
Yes	41.5%	241
Possibly	33.9%	197
Unsure	12.4%	72
Probably Not	6.7%	39
No	5.5%	32

Source: Auditor generated based on employee survey results

In addition to asking about employees' experiences when encountering and reporting fraud, waste, and abuse, the survey also sought responses regarding if employees had heard about possible instances of wrongdoing. Four specific examples were chosen based on a review of the types of reports that other

city whistleblower hotlines investigate. As shown in Exhibit 5, many employees who responded to the survey acknowledged that they had heard of employees engaging in acts of wrongdoing.

Exhibit 5: Some Employees Have Heard Of Possible Wrongdoing

Have you heard of at least one incident in the City in which the following might have occurred? Use of position or authority to advance a personal financial interest:		
Answer Options	**Response Percent**	**Response Count**
Yes	44.6%	259
No	45.6%	265
Unsure	9.8%	57

Have you heard of at least one incident in the City in which the following might have occurred? Exchange of money or gifts for City business or preferential treatment:		
Answer Options	**Response Percent**	**Response Count**
Yes	32.5%	189
No	55.8%	324
Unsure	11.7%	68

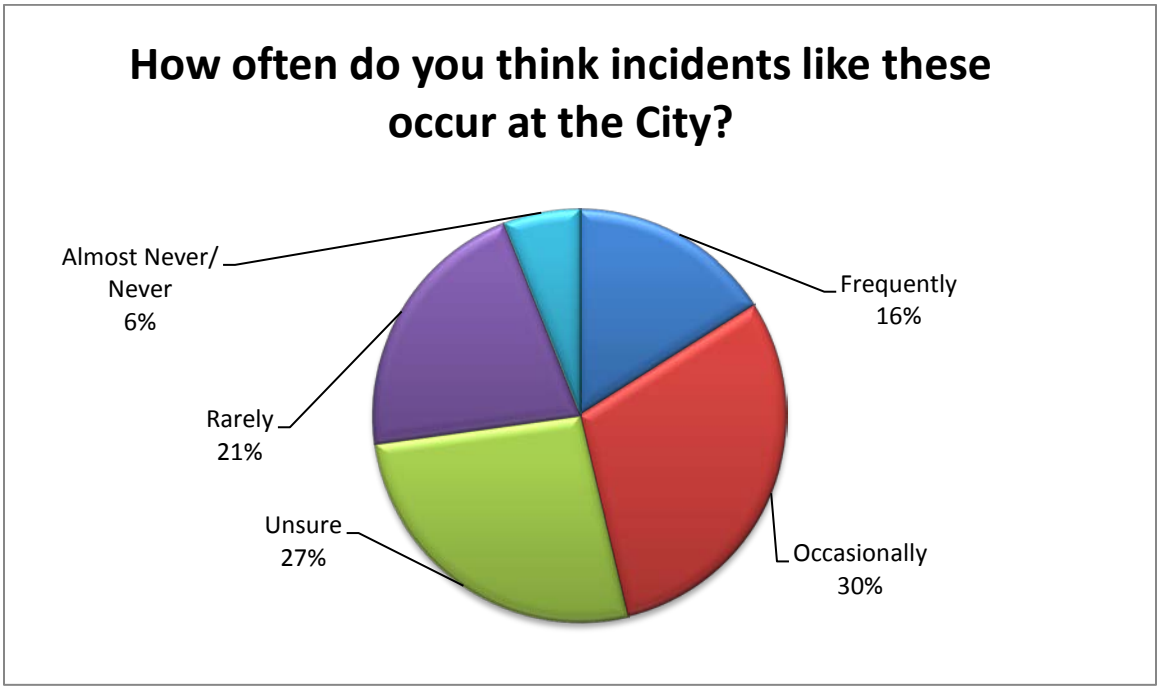
Have you heard of at least one incident in the City in which the following might have occurred? Completing timesheets to claim time not actually worked:		
Answer Options	**Response Percent**	**Response Count**
Yes	38.4%	223
No	54.6%	317
Unsure	7.1%	41

Have you heard of at least one incident in the City in which the following might have occurred? Use of City resources (like computers, vehicles, phones) for personal gain or for outside employment:		
Answer Options	**Response Percent**	**Response Count**
Yes	45.8%	266
No	43.5%	253
Unsure	10.7%	62

Source: Auditor generated based on employee survey results

In addition to asking about these types of incidents, the survey also requested that employees report their perceptions of how often the incidents occur at the City. While about a quarter said they were unsure, 46 percent answered that incidents occur frequently or occasionally. The breakdown of all answers is shown in the following exhibit:

Exhibit 6: Employees Have Various Views About How Often Above Incidents Occur



Source: Auditor generated based on employee survey results

The City could benefit from establishing an ethics code

The Institute for Local Self Government, an organization with the mission of promoting "good government at the local level with practical, impartial, and easy-to-use resources for California communities," encourages local governments to establish ethics codes. According to the Institute, ethics code goals are to encourage high standards of behavior, increase public confidence, and help public officials make decisions. An ethics code "creates a set of aspirations for behavior, based on values associated with public service held by public servants and the communities they serve. The process of adopting and reviewing an agency's ethics code enables agency officials to clarify these values and link them with standards of conduct," according to the Institute's *Developing a Local Agency Ethics Code: A Process-Oriented Guide*. However, while City leaders have discussed establishing a code of ethics in the past, the City does not have one in place.

About 79 percent, or 457 of the employees surveyed, said the City should have a code of ethics. Establishing an ethics code would complement the establishment of a whistleblower hotline well, and would formalize the City's expectations regarding ethical behavior.

State law sets requirements for establishing and running a whistleblower hotline, but local auditors have discretion in how to operate their programs

California Government Code Section 53087.6 allows local governments to create whistleblower hotlines. The following includes key points of this section and how it would pertain to the City:

- The City Auditor shall obtain approval from City Council before establishing a whistleblower hotline.

- The hotline would be used to receive calls from people who have information regarding fraud, waste, or abuse.
- The City Auditor may refer calls received on the hotline to the appropriate government authority for review and investigation.
- During the initial review of calls received, the City Auditor (or the appropriate government authority to whom the call is referred) shall hold in confidence information disclosed through the hotline. This includes the identities of the callers disclosing information and the people identified by the callers.
- Upon receiving specific information that an employee has engaged in an improper government activity, the City Auditor may conduct an investigative audit.
- The identity of the people providing information that initiated the investigative audit shall not be disclosed without their written permission, unless the disclosures are to law enforcement agencies that are conducting criminal investigations.
- The investigative audit shall be kept confidential except to issue a report of an investigation that had been substantiated or to release findings from completed investigations that are deemed necessary to serve the interests of the public.
- The identities of individuals reporting the improper government activities and the subject employees investigated shall be kept confidential.
- However, the City Auditor may provide a substantiated audit report and other information (including subject employee identities) to appointing authorities for disciplinary purposes.

While these requirements provide the framework for a whistleblower hotline, additional questions must be answered before establishing a hotline. The following are some key areas that should be considered before implementing a hotline, and would be crucial to consider if City Council directs the City Auditor to establish a hotline.

1. What would be the goals of the hotline?
2. How would whistleblower reports be received?
3. How would the City Auditor ensure confidentiality?
4. What kinds of information would be referred to other departments? What would be investigated by the City Auditor? How would unsubstantiated reports be treated?
5. What resources would be available inside the Office of the City Auditor, in other City departments, and external to the City to ensure that the hotline was managed appropriately?
6. How would the results of investigations be reported internally?
7. How would the results of investigations be reported publically?
8. How much would it cost to operate a whistleblower hotline, including the cost of investigative audits?

California cities run whistleblower hotlines differently, but have similar goals

Our review of other cities' hotlines found that different city auditors (or the equivalent positions at their respective cities) run their hotlines slightly differently. However, it appears that they have similar goals and approaches. Specifically, they focus on seeking complaints related to fraud, waste, and abuse to reduce the loss of government resources. Also, they stress protecting the identities of whistleblowers and promoting government accountability. The following shows a sample of other cities' stated focus and goals related to their hotlines:

Exhibit 7: Other Cities' Hotline Aim To Reduce, Fraud, Waste, And Abuse

Local Government	Hotline Focus and Goals
San Diego Office of the City Auditor	"The primary objective of the Fraud Hotline is to provide a means for City of San Diego employees and citizens to confidentially report (1) any activity or conduct in which he/she suspects instances of fraud, waste, or abuse and (2) violations of certain federal or state laws and regulations (e.g., laws prohibiting discrimination or whistleblower laws)."
San Francisco Office of the Controller	"The Whistleblower Program was created on behalf of San Francisco citizens and government employees to help make City government more accountable through the prevention and investigation of suspected waste, fraud, and abuse."
Oakland Office of the City Auditor	"Identify and stop loss of City resources; Act as a deterrent to fraud, waste and abuse; Provide a safe method for employees and the public to report suspected fraud, waste or abuse; Protect employees from retaliation; Ensure transparency, accountability and integrity in Oakland's government."

Source: Various San Diego, San Francisco, and Oakland publications about their whistleblower hotlines

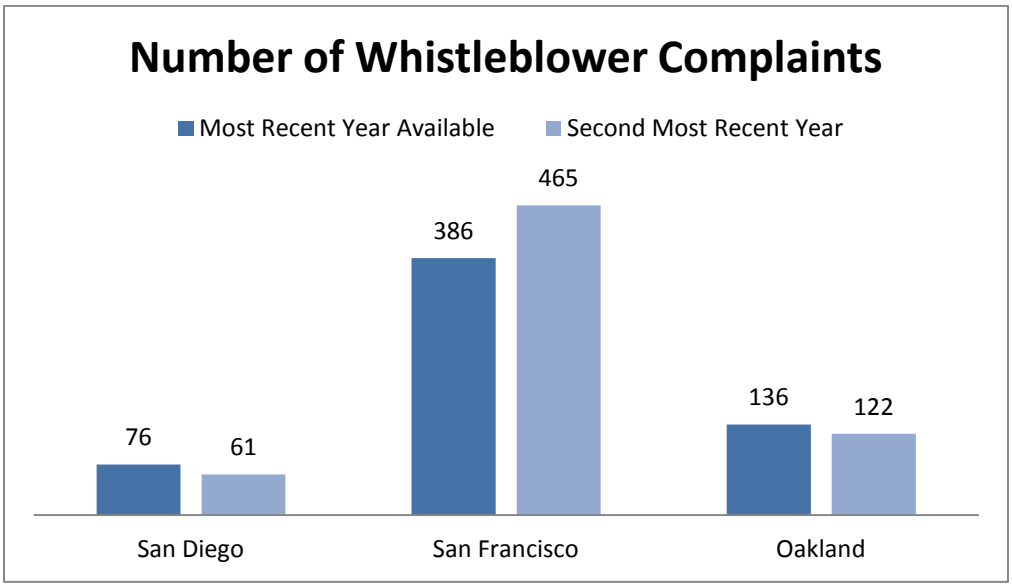
Hotline logistics and number of reports

Some variation exists in how cities handle the logistical operations behind their hotlines. For example, San Francisco receives whistleblower calls through its 311 phone system while the cities of Los Angeles, San Diego, Long Beach, and Oakland contract out these calls to independent third-party providers that send the cities reports detailing the calls. In addition to phone hotlines, some cities also accept complaints through their web-based forms while others do not. Generally, offices also accept in-person, e-mailed, and mailed-in complaints in addition to their regular reporting hotline methods.

The number of whistleblower complaints also varied from city to city and from year to year. The following shows some examples of the number of whistleblower complaints received in recent years by different cities. While we would have generally expected that larger cities would have more reports since there would be more people to provide information, this was not necessarily the case. Specifically, the City of San Diego has received fewer hotline calls in recent years than both San Francisco and Oakland even though these two cities have hundreds of thousands of fewer residents than San Diego.

The following shows the most recently available number of complaints received by these three cities in recent years:

Exhibit 8: The Number Of Whistleblower Complaints Vary From City To City And Year To Year:



Source: Various San Diego, San Francisco, and Oakland whistleblower hotline reports

Actions taken to respond to complaints

After receiving complaints, cities decide which ones to investigate internally, refer to other departments, or close. City whistleblower hotlines generally limit what types of cases they pursue and often exclude investigations that have been traditionally handled by Human Resources - like those related to harassment, discrimination and personnel issues.

Cities often report in public documents how they responded to allegations. For example, from July 1, 2009 to June 30, 2010, the San Francisco Office of the Controller investigated about 45 percent of the whistleblower complaints received and categorized the remaining complaints as follows:

- Not enough information (13.5 percent); complaints lacked sufficient information to investigate
- Referred to another department (12.2 percent)
- No action (12.4 percent); complaint not explicitly conveyed
- Outside of jurisdiction (13.7); regarding management decisions, or state or federal government
- Information request (3.1 percent); from individuals who request information on City departments or services

The Oakland City Auditor's percent of cases investigated from January through June 2011 was 47 percent, which is in line with the above San Francisco rate.

Cities provide summaries of some of the investigation results in public reports. Generally, they include the allegations or descriptions of the complaints as well as the resolutions or outcomes of the investigations. The resolution sections usually state if reports were substantiated or unsubstantiated.

Also, they report on corrective actions. The allegations and resolutions are usually brief (several cases are presented on each page) and some reports state that specific details were not disclosed to preserve confidentiality.

In addition to providing summary reports, the San Diego Office of the City Auditor also produces some more in-depth hotline investigative reports. Recent topics have included cases relating to a false request for reimbursement, employee malfeasance, and a misappropriation of city funds.

Establishing and running a whistleblower hotline in Sacramento could cost more than $200,000 per year, but could yield larger benefits

We estimate that implementing a whistleblower hotline would cost the City between $15,000 and $220,000 in the first year, depending on how the program is established. Two options are presented below. *Option One* implements a whistleblower hotline using the City Auditor's existing personnel. While staff members have had some experience and training related to detecting fraud, waste, and abuse, additional training in these areas would be necessary. Costs for implementing *Option One* include attending training so one auditor could become a Certified Fraud Examiner and contracting with a third-party provider for a hotline and case management system.

We contacted The Network, Inc., an independent third-party provider that runs 24-hour whistleblower hotlines and provides a case management system for investigations. The company estimates that the hotline and case management system will cost the City about $9,000 per year and that the City will receive between 100 and 150 reports each year. The costs of these services are included in both options presented. The Network, Inc. provides services to other city whistleblower hotlines, including those in Los Angeles, Long Beach, and San Diego. The following exhibit shows cost projections for *Option One*:

Exhibit 9: Establishing A Whistleblower Hotline With Current Staff

Option One Expenses	**First Year Estimate**
24-hour phone hotline, web intake, and case management system	$ 9,120
One-time system deployment	$ 2,000
Fraud Certification and Fraud Training	$ 4,000
Total	$ 15,120

Source: Auditor generated based on hotline cost estimate and training cost information

Due to the current workload of the Office of the City Auditor, adding this additional responsibility without another position would likely reduce the number of performance audits that could be

completed each year. Currently the office has three auditors in addition to the City Auditor. Each auditor is responsible for conducting individual performance audits under the direction and supervision of the City Auditor. Depending on the scope of audits, they are usually completed within six months to one year. In addition to conducting audits, auditors and the City Auditor also edit and review each others' draft audit reports to ensure accuracy and comply with Government Auditing Standards. Besides performance audits taking longer to complete, operating under *Option One* may limit how quickly whistleblower complaints could be investigated (since the auditors conducting investigations would still have other audit and audit review responsibilities).

Option Two adds an auditor/investigator position to the office. Ideally, this person would have experience investigating fraud, waste, and abuse and would work independently on investigations under the direction of the City Auditor. Personnel costs for this position are estimated below. Also, it is likely that the Office of the City Auditor will seek legal advice from the City Attorney's Office during whistleblower audit investigations. Depending on the types and complexity of allegations and investigations, attorney assistance could become extensive. An estimate for the partial cost of a City Attorney position is also included in the *Option Two* cost estimate.

In addition to estimating personnel costs, the *Option Two* estimate includes supplies, training, and the third-party provider's services:

Exhibit 10: Establishing A Whistleblower Hotline With Added Staff

Option 2 Expenses	**First Year Estimate**
Personnel Expenses	
Fully-Loaded New Auditor Investigator Position and City Auditor Time	$ 120,000
City Attorney Partial Position	$ 85,000
Non-Personnel Expenses	
Fraud Training	$ 1,000
Computer, recording device, equipment	$ 3,000
24-hour phone hotline, web intake, and case management system	$ 9,120
One-time system deployment	$ 2,000
Total	$ 220,120

Source: Auditor generated based on position cost estimates, hotline cost estimate and training cost information

These are estimates only. The total amount of time devoted by City staff would depend upon the number of complaints, as well as the number and complexity of resulting investigative audits. A large number of audits, and even one or two very complicated investigations, could demand additional staff resources, thus greatly increasing these costs.

Benefits could outweigh costs

As noted in the Background section, the Association of Certified Fraud Examiners advocates establishing whistleblower hotlines. The association found that having hotlines in place was the control associated with the greatest reduction in fraud loss. The ACFE estimates that a typical organization loses 5 percent of its annual revenues to fraud. If this 5 percent loss was applied to the City of Sacramento's expected Fiscal Year 2011-12 General and enterprise funds total revenue, it would equal more than $30.3 million per year. However, as noted previously, the City's current loss due to fraud is unknown. If the actual loss related to fraud was closer to 1 percent of annual General and enterprise funds revenues, the estimated amount would be about $6 million**.** The following shows the potential losses at different levels due to fraud.

Exhibit 11: Cost of Fraud Estimates Based on Percentages of General and Enterprise Funds Revenue

Possible loss Percentages	Loss amount due to fraud
1 Percent Loss	$6,064,480
2 Percent Loss	$12,128,960
3 Percent Loss	$18,193,440
4 Percent Loss	$24,257,920
5 Percent Loss	$30,322,400

Source: Auditor generated based on budget information

While savings may or may not be realized, some survey results related to fraud, waste, and abuse were troubling. Specifically, more than half of employees surveyed said they have had concerns about fraud, waste and abuse during their careers. While many reported these concerns, many said they did not because they feared retaliation or did not know who to report concerns to. Establishing a whistleblower hotline could create a method for employees to report information about suspected fraud, waste, and abuse without fearing retaliation.

As noted above, about 75 percent of employees surveyed indicated that if they encounter fraud, waste, or abuse in the future that they would or possibly would report information to a whistleblower hotline if it existed. In addition to survey responses presented in this report, the survey also sought employees' written comments. About a quarter of employees submitted comments. Some recurring points are summarized below

- When problems are reported, nothing is ever done to correct them.
- The City in general and some specific departments have cultures of corruption.
- A whistleblower hotline could be a deterrent.
- A hotline would only be successful if complaints were investigated and action was taken.

- A hotline could lower morale because people would feel like they were being watched and may have to defend themselves against false complaints.
- To be effective, employees will have to trust that they could stay anonymous when they report.
- Employees would be more accountable if there is a hotline in place.
- Fraud, waste, and abuse are common in the City.

RECOMMENDATIONS

We recommend that the City Council:

1. Provide the City Auditor direction regarding establishing a City whistleblower hotline in Fiscal Year 2012-13.
2. If Council supports establishing a hotline, direct management to identify a funding source.
3. If Council supports establishing a hotline, direct the City Attorney's Office to draft a whistleblower resolution and non-retaliation resolution for adoption by Council.
4. Direct the City Attorney and City Manager to establish a Citywide Code of Ethics.