



Report of the State Comptroller of Israel | May 2022

Systemic Topics

Embezzlement Prevention in Government Ministries and Government Companies



Embezzlement Prevention in Government Ministries and Government Companies

Background

When embezzlement occurs in an organization, it may cause severe damages, even endangering its continued existence. When it occurs in the government sector, it generates even more damage, such as affecting public trust in the government, perceiving the government system as corrupt also in international eyes, and adversely affecting the financial plans that are supposed to serve the public. Government organizations are exposed to embezzlement, but it is possible to reduce this risk by a variety of actions. Every government organization is responsible for performing these actions, which must be performed according to the regulatory parties' appropriate directives.

Key figures

NIS 6-9 billion

the estimated annual damage in Israel due to embezzlement¹

USD 4.5 trillion

the global annual income loss estimation due to embezzlement and financial irregularities²

80%

of the embezzlements discovered in Israel during the past two years were carried out by senior parties in the organizations³

74

government bodies replied to a detailed survey by the Office of the State Comptroller concerning the prevention of embezzlement in six main risk areas

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government ministries have a policy for ministry-wide risk management or a ministry-wide risk management steering committee (according to their replies to the survey)

82%

of the government ministries and government companies (on average) do not use innovative technologies to detect and prevent embezzlement

1 For further details see: <https://www.haifachamber.org.il/fraud>.

2 For further details see: <https://www.acfe.com/report-to-the-nations/2020/>.

3 For further details see: <https://www.grantthornton.co.il/insights1/BRS/dedicated-and-focused-testing-set2/>.



Audit actions



From December 2020 to July 2021, the Office of the State Comptroller examined the actions performed to prevent embezzlement in government ministries and government companies.

This audit is based on a comprehensive survey conducted in December 2020 by the Office of the State Comptroller among 74 government organizations – 23 government ministries and 51 government companies (the Examined Entities). The survey included six questionnaires in the main risk areas for government ministries and government companies: (a) risk management; (b) information systems; (c) human resources and salary; (d) procurement and inventory; (e) money collection; (f) payment methods. The response to the survey was almost complete – 99% of the entities responded to the questionnaires⁴. The Office of the State Comptroller conducted supplementary examinations in some government ministries and companies, the Accountant-General Department at the Ministry of Finance (the AG Department), and the Finance and Control Unit at the Government Companies Authority.

Key findings



The audit findings arising from the analysis of the government and public entities' response to the Office of the State Comptroller's survey:




Risk management


- All of the examined government ministries and 12 (24%) of the examined government companies did not formulate a risk management policy. 12 (24%) of the companies that had formulated a policy did not update it since its approval more than two years ago. Likewise, there was no organization-wide risks manager in any of the examined government ministries and in 6 (12%) of the examined government companies, and there was no risk management steering committee in all the examined government ministries and in 21 (41%) of the examined government companies.

4 Five questionnaires were not completed in the survey: The Ministry of Communications – questionnaire on risk management; the Ministry of Transport – questionnaire on human resources and salary; Meir Shreya – three questionnaires on money collection, payment methods and procurement and inventory.



- None of the government ministries had conducted an organization-wide risk assessment survey; one government company had not conducted an organization-wide risk assessment survey, and 5 (10%) of the government companies had completed the last survey more than four years ago, and it has not been updated since then.
- 36 (71%) of the examined government companies and one government ministry do not use an information system supporting the risk management array.
- No internal risk management audit had been conducted in any of the examined government ministries and 13 (25%) of the examined government companies. The AG Department's audit unit had not conducted any risk management audit in the government ministries. There are no follow-up, reporting, and audit procedures in organization-wide risk management in any of the examined government ministries and in 12 (24%) of the examined government companies. None of the examined government ministries and in 20 (39%) of the examined government companies have a mechanism for reporting failure and almost failure events.
- 32 (63%) of the government companies replied that they have a hotline for submitting complaints and reports, but only 4 (18%) of the government ministries reported having such a hotline.
- The government companies' risks assessment surveys are not received in the Government Companies Authority's "ANAFA" (data collection and supervision over companies) system or are not fully inputted there. Likewise, the system does not have an analyzing tool for the obtained information, which could indicate, among other things, gaps and irregularities.

 **Information systems** – no computerized controls for detecting irregularities and trends likely to indicate improper conduct in 7 (32%) of the examined government ministries and in 12 (25%) of the examined government companies. Most of the examined government ministries and companies (91% of the government ministries and 78% of the government companies) do not use innovative technologies to detect and prevent embezzlement. It was also found that two (9%) of the examined government ministries and 18 (35%) of the examined government companies do not restrict the connection of a mobile device to the computerized environment and that 10 (43%) of the examined government ministries and in 32 (63%) of the examined government companies there are no alerts of such attempted connections.

 **Human resources and payroll** – 8 (16%) of the examined government companies have no controls for detecting irregularities in the human resources, attendance, and salary systems. In 11 (22%) of the government companies, no interfaces are maintained between the attendance and payroll systems. Likewise, it was found that in 6 (12%) of the examined government companies, only one official signs the employment agreement of a new employee in the organization. It was also found that 19 (37%) of the



government companies have an official authorized to perform the activities of a full employment cycle.



Procurement and inventory – 16 (70%) of the examined government ministries and 17 (34%) of the examined government companies do not conduct an inspection of the suppliers' master file change log, and in 5 (10%) of the examined government companies there is one official who has authorizations to perform the activities of a full procurement cycle.



Money collection – 4 (21%) of the examined government ministries and 5 (12%) of the examined government companies do not check the balances in their clients' bookkeeping ledgers, and 14 (34%) of the examined government companies do not check that the recipient of a receivable is restricted from making journal entries in the system. Likewise, 6 (32%) of the examined government ministries and 18 (44%) of the examined government companies accept non-"payee only" cheques, and 4 (10%) of the government companies accept cheques without the payee's name.



Payment methods – in 21 (42%) of the examined government companies, the official making the bank reconciliations also has access to the organization's payment methods or money collection system. Likewise, 12 (30%) of the 40 government companies making bank transfers do not have a restricted list of the suppliers' bank accounts only to which funds may be transferred.



The Office of the State Comptroller commends the observance of the separating the computerized environments principle when developing information systems, both in the government ministries and in government companies.

The Office of the State Comptroller commends the Government Companies Authority's publication of the updated and detailed risk management directive in 2020.



Mapping the status of the leading controls in government ministries and government companies (an evaluation based on the audited bodies' replies to the Office of the State Comptroller's survey)

Government Ministries	Government companies Classified 9 and above	Government companies classified 1-8	
			<div>High-level control</div> <div>Reasonable control</div> <div>Partial control</div> <div>Low-level control</div>
			Risk management
			Risk management policy
			Organization-wide risk manager
			Risk management steering committee
			Conducting a risk assessment survey
			Information systems supporting risk management
			Internal audit on risk management
			Follow-up, reporting and control procedures in the field of risk management
			Independent reporting mechanism
			Hotline
			Information systems
			Computerized controls for locating irregularities
			The use of advanced technologies
			Restriction on the connection of a mobile device
			Human resources and payroll
			Controls on irregular data
			An interface between the attendance system and the salary system
			One signature on an employment agreement
			One official with authorizations to perform a full employment cycle
			Procurement and inventory
			Controls on the suppliers' master file changes log
			One official with authorizations to perform a full procurement cycle
			procurement circle
			Money collection
			Continuous reconciliation of bookkeeping ledgers
			Recipient of receivable who can make journal entries in the system
			Receipt of cheques, which are not "payee only"
			Receipt of cheques without payee's name
			Payment methods
			Official making bank reconciliations with access also to payment methods
			Restricted list of suppliers' bank accounts



Key recommendations



It is recommended that the AG Department and the Government Companies Authority examine the need to update their directives in various fields to the government ministries and government companies, respectively.



The government ministries and companies should formulate a risk management policy, update it every year and have it approved by the relevant parties in the organization. It is recommended that the government ministries set up a comprehensive array of risk management in conjunction with the AG Department, which will include a chief risk manager and a risk management committee to examine the risk management policy, make decisions regarding risk reduction and track and supervise their implementation. It is recommended that the government companies that have not yet appointed a chief risk manager complete the appointment. Likewise, the government companies where no risk management committee has been formed should form such a committee, the government ministries and companies must conduct a risks assessment survey of all the risks to which the organization is exposed at least every four years and update it regularly.



It is recommended that the internal auditors in government companies consider the importance of risk management in the company and consider integrating it into their audits. It is recommended that the internal auditors in the government ministries and the audit unit at the AG Department incorporate a risk management audit, by the apportionment of responsibility between them. Likewise, it is recommended the Ministry of Foreign Affairs and government companies assimilate an information system supporting risk management. Furthermore, it is recommended that all the government ministries and government companies anchor in their procedures the method of tracking, reporting, and control over all risk management matters and determine procedures and a reporting mechanism for the organization's risk manager of failure or near-failure events, for treating them and preventing their reoccurrence.





It is recommended that government companies and ministries that have not yet set up a designated mechanism for submitting complaints and reports (hotline) consider establishing such a mechanism to transfer information about suspected embezzlement.



It is recommended that government ministries and companies implement computerized controls to help detect and prevent embezzlement and consider the necessity to implement advanced technologies likely to serve this purpose. Where government ministries and government companies do not restrict the connection of mobile devices to workstations, it is recommended that they do so.



-  Given the deficiencies in the implementation of operational processes controls, it is recommended that government ministries and companies consider the necessity to implement and assimilate appropriate controls into the human resources and salary, procurement and inventory, money collection, and payment methods processes. It is essential to implement and incorporate efficient and effective controls to reduce the risk of embezzlement.
-  It is recommended that the Government Companies Authority examine the upgrading or replacement of the ANAFA system, so that it will be possible to promptly receive all the reports government companies are required to deliver to the Authority, including risk assessment surveys, as well as analyze the gaps and irregularities arising from these reports.



Fields where deficiencies were demonstrated in the embezzlement preventing controls in government ministries and government companies Report



Human resources and payroll

- General
 - Controls for detecting irregularities
 - Maintaining interfaces between systems
 - Approval of attendance reports
 - Handling irregularities
- Payroll
 - Controls over employment agreements and salary conditions
 - Controls over salary calculation
 - Control of the method of salary payment
 - Analytical controls
- Human resources
 - Maintaining procedure of continuous vacation



Procurement and inventory

- Management of suppliers' system
 - Approvals required for setting up a supplier in the system
 - Controls for setting up a supplier in the system or when changing supplier's details
 - Control over changes log in the suppliers' master file
- Procurement order
 - Controls when making procurement orders
 - Segregation of Duties
 - Controls over invoice and payment reception
- Inventory
 - Controls over management of inventory and warehouses



Money collection

- Regular and annual reconciliation of the clients' bookkeeping ledger
- Restricting authorization for registering journal commands of an employee who receives receivables in an organization
- Controls over collection by cheques
- Control over receipt of receivables in the organization's coffers via a mystery consumer



Payment methods

- Use of cheques
 - Recording cheques manually
 - Tracking and control over cheques transferred for signature
- Banks reconciliation proceedings
 - Frequency of making bank reconciliations
 - Segregation of Duties
- Bank transfers
 - A restricted list of bank accounts for bank transfers
- Masav (bank clearing center) transfers
 - Implementation of the requirement for two signatures for Masav transfers
 - Control after Masav transmission
- Control over credit card expenses
- Surprise count of petty cash



Summary

The scope of the financial activity of government ministries and companies, the nature of these entities, their complexity, and their large number of employees – expose them to embezzlement, which should be prevented. This audit's findings indicate deficiencies in preventing embezzlement in the risk management array and in the information systems. Likewise, the findings indicate deficiencies in the examination of the implementation of the operational controls in human resources and payroll, procurement and inventory, money collection, and payment methods. These operational controls are based on work methods and best practices recognized as effective and efficient in preventing embezzlement.

A comprehensive and complex proceeding is required to prevent embezzlement, including establishing an ethical organizational culture, reinforcing awareness among the organization's employees, early identification of the risks and weak points in the organization's systems, establishing an orderly plan for the prevention of embezzlement and assimilating designated risk reduction controls and systems. This proceeding is part of standard norms in organization-wide risk management, including embezzlement risks, developed over recent decades. The government ministries and the government companies, as well as the AG Department and the Government Companies Authority, should consider the conclusions and recommendations raised in this report, draw conclusions from the deficiencies noted in the report and rectify them.

