



State Comptroller of Israel | Local Government Audit | 2022

Systemic Audit

Prevention of Embezzlement and Fraud in Local Authorities



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Background

In Israel, 257 local authorities manage budgets of about NIS 71 billion and employ about 165,000 workers. They manage numerous financial processes, such as procurement processes, collection of property taxes and payment of wages, and managing property and equipment. As public trustees, local authorities should manage their financial affairs and assets carefully and maintain the integrity of the assets and public funds. Preventing embezzlement and fraud is an expression of the previously mentioned duty, and it ensures good governance and integrity. Professional knowledge about preventing embezzlement and fraud has developed in recent decades, and principles have been formulated. An international survey from 2020 of about 2,500 embezzlement incidents exposed worldwide raised that the loss due to such embezzlements is estimated at USD 3.6 billion and that organizations worldwide lose about 5% of their revenue each year due to fraud, embezzlement, and financial irregularities.



Key figures

**NIS 71
billion**

Local authorities total budget in 2019; That year they employed about 165,000 workers

32%

of the embezzlements and frauds exposed in government organizations around the world in 2019 were in local authorities

68%

of the embezzlement and fraud incidents investigated by accounting firms in Israel in 2018–2019 were employee embezzlement

43%

of the embezzlement incidents were exposed following reports from within the organization – according to a 2019 survey by the International Association of Certified Fraud Examiners – ACFE. The median loss due to embezzlement incurred by organizations with a hotline mechanism was 50% lower than that of entities with no such mechanism

14

local authorities out of the 21 audited reported at least one incident of embezzlement or fraud that was perpetrated and exposed in 2015–2021. A total of 21 embezzlement incidents were exposed

**about NIS
9.3 million**

the estimated financial damage caused to 14 local authorities and another authority (**Jisr az-Zarqa**) that reported exposed embezzlement and fraud incidents in 2015–2021

2

number of local authorities out of the 21 audited (**Eilat** and **Be'er Sheva**) whose managements conducted a risk survey and derived work plans therefrom

9

number of local authorities out of the 21 audited formulated a code of ethics. Six of them implemented it



Audit actions



From April 2021 to January 2022, the State Comptroller's Office examined embezzlement and fraud prevention in 21 local authorities that manage the most significant budgets: **Eilat, Ashdod, Ashkelon, Be'er Sheva, Bnei Brak, Bat Yam, Herzliya, Hadera, Holon, Haifa, Jerusalem, Kfar Saba, Modi'in-Maccabim-Reut, Netanya, Petah Tikva, Rishon Lezion, Rehovot, Ramat Gan, Ra'anana and Tel Aviv-Yafo** municipalities and the **Mateh Binyamin** Regional Council (local authorities audited). Furthermore, the regulations of the Ministry of Interior were also examined.

In addition, in four municipalities, **Be'er Sheva, Haifa, Petah Tikva, and Rishon Lezion**, an in-depth audit was conducted (local authorities audited in depth) on individual actions taken to prevent fraud and embezzlement in core processes in five areas.

Key findings



The Regulator's actions – the Ministry of Interior has not established pan-organizational guidelines to prevent embezzlement and fraud. In addition, the audits it conducted in the local authorities do not directly address these aspects. It should be noted that Australia, for example, uses a program to prevent embezzlement and fraud at the local level. In 2018, the United Nations published a guide to contend with corruption in local authorities. The guide includes, among other things, a corruption risks examination, and a design of a supportive organizational culture for preventing, monitoring, and reporting corruption.







Reporting and conclusion drawing mechanisms – the 21 local authorities audited were asked to report to the State Comptroller's Office on embezzlement and fraud incidents that occurred therein and were exposed between January 2015 and May 2021. Two-thirds of them (14) reported 21 incidents of embezzlement and fraud exposed. Eight reported a single incident, and six reported more than one incident. Seven incidents were of the education departments' activities, five embezzlement incidents were of inventory management, and the rest were of various processes. Nine of the 21 embezzlement incidents exposed and reported by the local authorities were at over NIS 50,000, and two incidents were at NIS 1.2 million or more. The cumulative amount of all the incidents exposed and reported was estimated at NIS 6,000,000.



It was found that the local authorities in Israel are not instructed to report to the Ministry of Interior embezzlement or fraud incidents discovered, and the Ministry of Interior has no internal procedure for handling them. It was further found that, as a rule, the Ministry



of Interior does not conclude from embezzlement or fraud incidents in the local authorities it has learned of, nor does it publish consolidated information to all local authorities about conclusions drawn from such embezzlement and fraud, and the necessary action to take. Haifa District of the Ministry of Interior, which concluded from an embezzlement incident at the **Jisr az-Zarqa** Local Council in 2016, is commended. In this embezzlement incident, an outside accountant who provided services to the council for NIS 3.3 million was convicted of theft by changing suppliers' bank account details to his associates' account details. However, the conclusion drawn from the embezzlement in **Jisr az-Zarqa** was not shared with local authorities outside the Haifa district.

-  **Conducting and updating a risk survey** – five of the 21 auditors of the local authorities audited did not conduct a risk survey, and three conducted a risk survey in some municipal departments. In three of the municipalities that prepared a risk survey, more than five years have passed since it was completed. The Ministry of Interior has not set surveys updating guidelines for local authorities. As for conducting a risk survey by the management of the local authority, it was found that except for two municipalities – **Eilat** and **Be'er Sheva** – the local authorities' management did not conduct a risk survey or use it.
-  **Appointing a responsible entity to prevent embezzlement and fraud in the local authority** – only one of the 21 local authorities audited appointed an accountable body to prevent embezzlement and fraud.
-  **Procedures, training program, and means for anonymous reporting (hotline)** – the 21 local authorities audited have no dedicated process to anchor prevention of embezzlement and fraud policies, incorporate the actions required to prevent embezzlement and fraud, report mechanisms and methods of handling embezzlement incidents discovered. In addition, the 21 local authorities audited do not have a pan-organizational and dedicated training program on the prevention of embezzlement and fraud, and there are no means for anonymous reporting (hotline) on suspicions of embezzlement and fraud to the management.
-  **Rotation between functionaries and surprise inspections** – 20 of the 21 local authorities audited do not implement rotation between employees in positions affiliated with financial matters or the management of the authority's resources due to organizational difficulties and limitations; **Ra'anana** municipality is the only one that implements rotation in positions affiliated with salary and human capital management. **Be'er Sheva** municipality reported that it implements rotation in specific departments, such as the property tax department. As for surprise inspections – 14 local authorities out of the 21 audited do not conduct surprise inspections; seven – conducted surprise inspections – most at the municipal coffers or on a specific issue.



-  **Prevention of embezzlement and fraud related to payments to suppliers** – it was raised that the Ministry of Interior has no guidelines to manage the payment process to suppliers and the controls required to prevent embezzlement and fraud. The Ministry of Interior addressed, in the audits, it conducted, only one aspect, which is the failure to reconcile accounts with banks, credit card companies, and major suppliers, from among the various aspects included in the contracting process with a supplier. It was also found that the local authorities audited in depth – **Be'er Sheva, Haifa, Petah Tikva, and Rishon Lezion** – reduced those risks. Still, it is recommended they also implement preventive, warning, locating controls, such as rotations between officials, reliability of data input controls when opening and updating a supplier card, adding computerized controls on the supplier data to prevent duplication or improper engagements and creating an interface between the financial and logistics systems.
-  **Prevention of embezzlement and fraud related to human capital management** – as a rule, the four audited in-depth local authorities – **Be'er Sheva, Haifa, Petah Tikva, and Rishon Lezion** – implement controls enabling the mitigation of the risks of embezzlement and fraud in human capital management. However, there are further actions and controls they should implement. For example, the four above-mentioned local authorities reported that some employees were given sweeping permission to handle all the data of the local authority employees, thus increasing the risk of embezzlement; they do not implement rotations between positions due to organizational difficulties and do not require employees in sensitive positions to take continuous leave; the controls for entering the data when opening a new employee card are not optimal and lack control over changes in the master files of employees and retirees and over the processes of removing an employee from the computer systems.
-  **Prevention of embezzlement and fraud related to wage payments** – it was found that the local authorities audited in depth, as a rule, implement controls to prevent risks of embezzlement and fraud in wage payments to employees. However, **Haifa** municipality does not have a separate payroll control department, and employees in the Payroll Department perform the control; **Be'er Sheva** municipality has begun setting up a payroll control unit, but by the audit end, the process has not been completed. In addition, payroll accountants in the audited authorities can enter payroll entitlements for other payroll accountants or change details for employees whose employment with the local authority has ended. In **Be'er Sheva** and **Haifa**, payroll accountants can also enter entitlements for themselves and their relatives who work for the municipality. In addition, in **Be'er Sheva, Haifa, and Rishon Lezion** municipalities, controls to detect improper changes made to the master files of the employee data generated in the Human Resources Department are not performed.
-  **Prevention of embezzlement and fraud related to the imposition of property taxes and their collection** – as a rule, the audited in-depth local authorities implement controls that prevent risks of embezzlement and fraud in property taxes.



Thus, for example, they all reported that they periodically review the compatibility between the classification codes in the computer systems and those outlined in their property tax order and require that at least two different functionaries be involved in changing the classification of a property, writing off debts or restoring funds paid in excess. However, in some processes, the controls are unsatisfactory: **Petah Tikva** municipality has not regulated the procedure for authorizing users in the municipal collection system; **Haifa, Petah Tikva, and Rishon Lezion** municipalities do not conduct analytical controls over the number of changes made to properties in the municipality to detect unusual actions and suspicions of embezzlement.



Prevention of embezzlement and fraud in the management of municipal inventory – **Be'er Sheva, Haifa, and Petah Tikva** municipalities cannot ascribe in the designated computer systems the inventory items to the employees who received them. This is especially important during the Covid-19 pandemic as many employees were loaned laptops since they transitioned to remote work. It was also found that **Be'er Sheva** and **Haifa** municipalities do not apply analytical controls on inventory losses.



Code of Ethics – nine out of the 21 local authorities audited have a code of ethics; six of the nine also carried out actions for its implementation.

Key recommendations



The Regulator's actions – it is recommended that the Ministry of Interior examine the systemic and organizational issues of embezzlement and fraud prevention in local authorities, according to the knowledge development on the subject. Accordingly it should establish guidelines regarding control environment characteristics, risk assessment, control measures, information and communication within the organization and monitoring actions, and instruct their accountants to conduct audits on this subject at a frequency to be determined by it. As part of the audit, it is recommended to refer to the knowledge and principles that have developed in the field and to international experience.



Conducting a risk survey by the internal auditors and the managements of the local authorities – the local authority internal auditors of **Bnei Brak, Bat Yam, Haifa, Rehovot** and **Tel Aviv-Yafo** who have not yet conducted a risk survey, should do so, as required by the Director General of the Ministry of Interior Circular, and the auditors of the **Ashdod, Hadera** and **Holon** should complete the partial risk survey they conducted to a full survey. It is recommended to update surveys conducted more than five years ago. It is also recommended that the Ministry of Interior establish guidelines for local authorities to update the surveys. Moreover, that local authority managements



conduct risk surveys and derive therefrom multi-year work plans to mitigate the risks that arise therefrom.



Pan-organizational preparations for the prevention of embezzlement and fraud – it is recommended that the audited 21 local authorities conduct pan-organizational actions to prevent embezzlement and fraud and thus mitigate the related risks. Among the actions required are: appointing a responsible entity, formulating a dedicated procedure for anchoring policy, formulating a pan-organizational and dedicated training plan, employing means for anonymous reporting (hotline) to the authority's management on suspicions of embezzlement and fraud and informing employees of its existence, implementing, to the extent possible, of rotation mechanisms in positions whose core occupation is managing funds, resources and assets of the local authority and conducting surprise inspections on material topics.



Prevention of embezzlement and fraud related to payments to suppliers – it is recommended that the Ministry of Interior publish guidelines and controls on the payment process to suppliers to prevent embezzlement and fraud. It is further recommended that the Ministry of Interior conduct audits on other aspects in local authorities besides failing to reconcile accounts with banks, credit card companies, and major suppliers. It is recommended that **Be'er Sheva, Haifa, Petah Tikva, and Rishon Lezion** map all the controls they perform in payment to suppliers and rectify the deficiencies found in the audit. Such as the control of two officials over the input of data when opening a supplier card, adding computerized controls on supplier data to locate duplications and to prevent improper engagements and the creation of an interface between the financial and logistical systems.



Prevention of embezzlement and fraud related to human capital management – it is recommended that **Be'er Sheva, Haifa, and Petah Tikva, and Rishon Lezion** which were audited in depth – formulate internal procedures or guidelines regarding the lack of controls in core processes and uphold the principle of segregation of duties by reducing sweeping privileges to employees. It is also recommended to introduce compulsory continuous leave for employees in sensitive positions and to improve controls over opening an employee card.



Prevention of embezzlement and fraud related to wage payments – it is recommended that **Be'er Sheva, Haifa, Petah Tikva, and Rishon Lezion** maintain the segregation of duties principle; thus, payroll accountants cannot enter salary entitlements for their colleagues in the accounting division or change details of employees whose employment has ended. It is further recommended that the **Be'er Sheva** and **Haifa** municipality accountants cannot enter entitlements for themselves and their relatives working for the authority. It is also recommended that the local authorities implement controls to detect improper changes made to the master files generated in the Human Resources Department.



Prevention of embezzlement and fraud related to the imposition of property taxes and their collection – it is recommended that **Petah Tikva** municipality regulate the authorization procedure for users of the municipal collection system and that **Haifa, Petah Tikva** and **Rishon Lezion** municipalities implement analytical controls on the number of changes made to properties.



Prevention of embezzlement and fraud in the management of municipal inventory – it is recommended that **Haifa** and **Petah Tikva** ascribe in the computer systems the inventory items to the employees who received them. It is also recommended that **Be'er Sheva** and **Haifa** municipalities apply analytical controls on inventory losses.

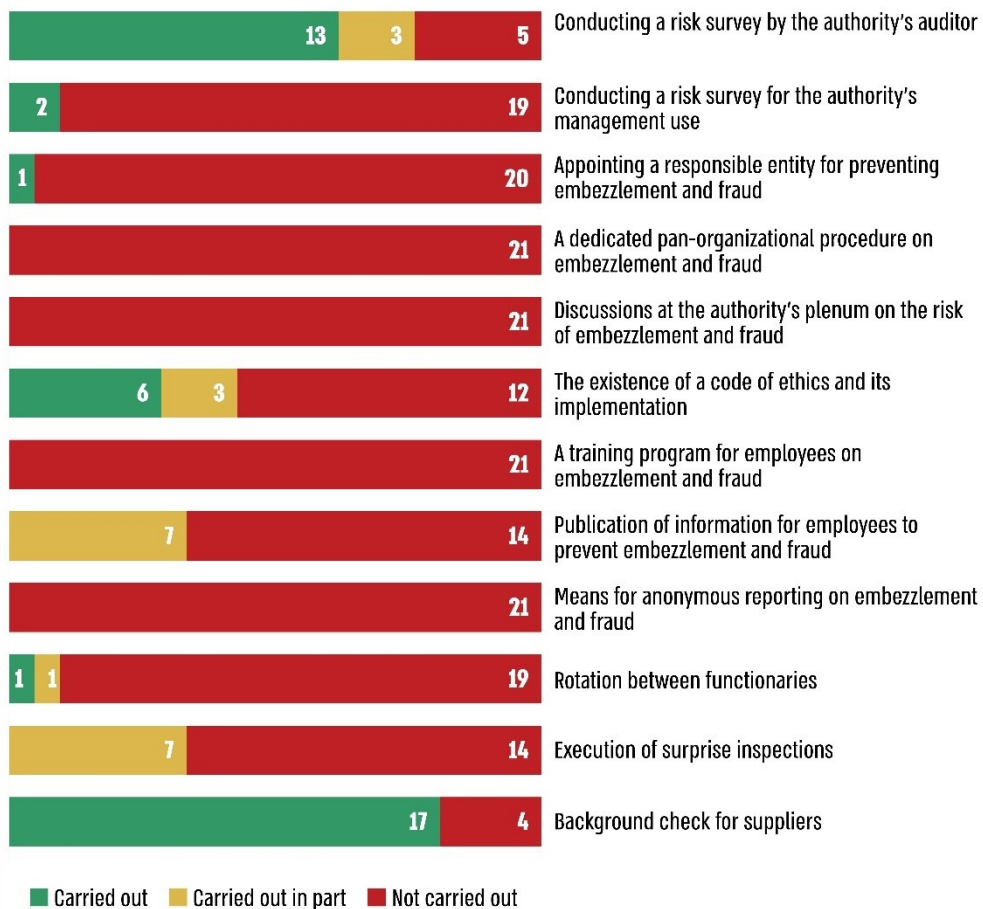
Management of embezzlement and fraud risks according to the COSO organization model *



* Committee of Sponsoring Organizations of the Treadway Commission.



Distribution of local authorities audited according to the state of execution of pan-organizational actions for the prevention of embezzlement and fraud



Summary

The risk of embezzlement and fraud is inherent in the activities of any organization. In recent decades, professional knowledge about the prevention of embezzlement and fraud has developed in the world, and principles and guidelines have been formulated for improving the control and risk management environment. However, the audit found deficiencies in the



Ministry of Interior regulations. This is reflected in the lack of guidelines in preventing embezzlement and fraud at the pan-organizational level and regarding the control environment, in the absence of reporting and drawing of conclusions, and the scarcity of audits focused on this area.

The audit of the 21 most prominent local authorities with the most significant budgets raised that they do not implement many pan-organizational actions, which international standards and professional literature found to be effective in mitigating the embezzlement and fraud damage and in their brief exposure.

Deficiencies were found in the audit of the four audited in-depth authorities, such as a scarcity of audits by the Ministry of Interior and of the authorities' auditors of embezzlement and fraud prevention. It was also found they implemented preventive and locating controls in the areas examined. However, there are individual work processes that require improvement, and individual controls should be added and some of the controls tightened.

As public trustees, local authorities should manage their financial affairs and assets carefully and maintain the integrity of the assets and public funds. The Ministry of Interior should form a comprehensive regulation, and local authorities should formulate policies and implement actions and controls to prevent embezzlement and fraud and to protect public funds.