



Mandatory Vacations



City of Charlotte
Internal Audit Department
600 E. Fourth St.
Charlotte, NC 28202

Staff

City Auditor

Gregory L. McDowell, CPA, CIA, CFE

Audit Supervisor

Marie Marsicano

Senior Auditor

Kyle Sutherland, CPA

Mandatory Vacations Audit Executive Summary

Purpose

Consideration of a mandatory vacation or job rotation policy.

Background

Fraud prevention experts and financial institutions have long-recommended employees in positions of fiscal trust be required to take an annual vacation leave of at least five consecutive workdays.

The Association of Certified Fraud Examiners (ACFE) Report to the Nations recommends mandatory vacations as a strong anti-fraud control.

The report notes the following behavioral red flags were present in 12.5% of the cases examined:

- Refusal to take vacations
- Control issues, unwillingness to share duties

Municipal frauds have often been related to the absence of mandatory leave policies.

Conclusion

The implementation of a pro-active policy to address mandatory vacation or rotation of employees in financial and IT-related positions would achieve best practices for fraud prevention.

Highlights

The City should establish a Citywide Mandatory Vacation, or Job Rotation policy.

- For typical embezzlements to succeed, an employee needs to be constantly present to manipulate records and respond to inquiries.
- The City does not require mandatory vacations as part of its internal control system.
- 872 employees used less than 40 hours vacation leave in FY 2018.
- Of these, 82 held job titles indicating financial or IT positions.

Recommendations

- 1) Human Resources (HR) should establish a citywide policy related to mandatory vacations/job rotation.
- 2) The City should restrict, limit, or monitor network access when a key employee takes planned leave.

Actions Planned

HR will work with Finance and Innovation & Technology to identify the positions that will be affected by the new policy. A pilot program will be initiated, followed by assessment and full rollout by early 2020.

Contents

Highlights	1
Background	3
Objective	4
Scope, Methodology, and Compliance	4
Findings and Recommendations.....	5
The City should establish a Citywide Mandatory Vacation, or Job Rotation policy.	5
Conclusion.....	6
Distribution of Report	6

Background

As part of a fraud awareness initiative in FY 2016, the City Auditor and Finance management completed the Association of Certified Fraud Examiners (ACFE) fraud prevention checklist, which is designed to help organizations measure the effectiveness of their fraud prevention measures. During subsequent discussions, concerns related to mandatory vacations were identified. Those efforts raised the priority for this audit.

Employees in positions of fiscal trust are often required to take an annual vacation leave of at least five consecutive workdays, to reduce the risk of fraud which often requires an employee's constant presence to perpetuate. The use of mandatory vacations is considered a best practice among financial institutions. The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by Congress to maintain stability and public confidence in the nation's financial system. The FDIC Regulations Manual states:

“Banks should have a policy that requires all officers and employees to be absent from their duties for an uninterrupted period of not less than two consecutive weeks. Management should consider suspending or restricting an individual's IT access rights during periods of prolonged absence.”

The ACFE Report to the Nations on Occupational Fraud and Abuse recommends mandatory vacations as a strong anti-fraud control, and includes it on the fraud prevention checklist designed to help organizations test the effectiveness of their fraud prevention measures.

According to the 2016 Report, for all frauds reported by the global study, mandatory vacation controls were in place only 19.4% of the time. In 12.5% of the cases examined, the report notes that of the three main categories of fraud committed by employees (asset misappropriation, corruption, and financial statement fraud), these behavior red flags were present:

- Refusal to take vacations
- Control issues, unwillingness to share duties

The report noted the median costs/duration of a fraud based on specific controls. The table below shows the potential impact that incorporating mandatory vacations has had in detecting fraud:

Mandatory Vacation/Job Rotation Controls			
Category	Control in Place	Control Not in Place	% Reduction
Median (\$) Loss of Fraud	\$89,000	\$170,000	48%
Median Duration of Fraud	10 Months	18 Months	44%

(Note: for purposes of its report, the ACFE considers mandatory vacations and job rotation as the “same” control and has combined the data.)

The 2018 ACFE Report states that the Government and Public Administration industry reported the third most frauds, behind Banking/Financial Services and Manufacturing.

The largest municipal fraud in U.S. history occurred in Dixon, Illinois from 1990 to 2012. The City Controller embezzled \$53 million dollars from the City. There was no indication of fraudulent activity until a clerk discovered a questionable account while the Controller was on leave.

In 2013, the City of Charlotte was the victim of an embezzlement of CATS light rail fare evasion fines. The employee of a City vendor (which was under contract to collect the fines) embezzled over \$50,000 and issued counterfeit receipts. The fraud was detected after the employee was absent due to illness. (The City accepted a reimbursement of \$50,750, which Internal Audit reviewed and supported. See CATS Fare Evasion Fines Audit Report issued June 25, 2014.)

In recent years, the use of mandatory vacations as an effective control has expanded to include information technology (IT) and information security roles. During the time away from the job, organizations have begun to audit the system activities of sensitive IT employees (e.g., database administrators) and identify any actions that could negatively affect IT assets.

Objective

This report addresses a narrow scope issue regarding consideration of a mandatory vacation or rotation policy.

Scope, Methodology, and Compliance

Scope

Evaluate annual leave taken by employees in key (financial and IT-related) roles throughout the City in FY 2018, with limited review of prior years.

Methodology

Audit staff performed the following procedures to accomplish the audit objectives:

1. Inquiries and interviews
2. Analyzed the amount and frequency of annual leave taken

Compliance

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.

Findings and Recommendations

The City should establish a Citywide Mandatory Vacation, or Job Rotation policy.

For typical embezzlements to succeed, an employee needs to be constantly present to manipulate records and respond to inquiries. If an employee is required to be absent for at least five consecutive workdays, the likelihood of any illegal actions succeeding is reduced, as a coworker (filling in) would be required to answer requests during the employee's absence.

Currently, the City does not require mandatory vacations as part of its internal control system. The City manages the risk of fraud by incorporating segregation of duties, and requiring multiple levels of approval within the Enterprise Resource Planning (ERP) system, Munis.

Based on PeopleSoft records, 872 City employees (including new hires, separations and FMLA leaves) used less than 40 hours vacation leave in FY 2018. Some of these employees may have not accrued as much as 40 hours leave. However, this overall number excludes employees who took non-consecutive days exceeding 40 hours. Therefore, a greater number of employees may have not have taken a full week of vacation in FY 2018.

- Additional observation: 83 employees reported zero vacation hours for one or more of the three years FY 2016-2018.

Of the 872 identified above, 82 held job titles indicating they were employed in financial or IT-related positions. These 82 individuals were mostly employed in the following four departments: I&T (29), Aviation (12), Water (11), and Finance (10). The remaining 20 employees represented six additional departments.

Recommendation A: Human Resources should establish a citywide policy related to mandatory vacations and job rotation. At a minimum, the policy should address all positions with financial responsibility, and IT roles. Instituting a policy will aide in the cross training of employees and provide assurance that the City has proper internal controls in place to detect and prevent fraud. Establishing a policy is a cost-effective strategy to strengthen internal controls and reduce risk.

Value Added: Risk Reduction

HR Response: Human Resources agrees. We will work with Finance and Innovation & Technology to identify the positions that will be affected by the new policy. Our goal for policy implementation is to initiate a pilot program by July 31, 2019. The pilot program will be assessed after calendar year-end to determine the effectiveness and establish a rollout date for all positions falling under the policy.

Recommendation B: As an employee in a financial or IT role takes planned leave (or is rotated to a different position for 40 or more hours), the City should restrict, limit, or monitor network access until they return to work.

Value Added: Risk Reduction

HR Response: Human Resources agrees. We will work with Finance and I&T to establish how job rotation and/or access restriction will be implemented.

Finance Response: Agrees.

Innovation & Technology Response: Innovation & Technology agrees with the recommendation and will work with HR and Finance to: (1) develop an approach for identifying these employees; and (2) implement a supporting process to restrict/limit/monitor network access for these employees that meets the intent of the recommendation.

Conclusion

The implementation of a pro-active policy to address mandatory vacation or rotation of employees in financial and IT-related positions would achieve best practices for fraud prevention.

Distribution of Report

This report is intended for the use of the City Manager's Office, City Council, and all City departments. Following issuance, audit reports are sent to City Council and subsequently posted to the [Internal Audit website](#).