

Fraud Prevention and Detection: Special Investigations, Information and Examples

Minnesota Association of County Planning and Zoning
Administrators Conference
October 12, 2023

Mark Kerr
Special Investigations Director, OSA



Legal/Special Investigations Division

The Office of the State Auditor's Legal/Special Investigations Division performs discretionary reviews and investigations regarding specific allegations of theft, embezzlement, or unlawful use of public funds or property.

It updates the Legal Compliance Audit Guide promulgated by the OSA for audits of political subdivisions. *See* Minn. Stat. § 6.65.

It provides legal compliance information and training to local government officials.

Fraud – Example

- MN School District Example – Rod Thompson
 - P-Card
 - The OSA provided an Investigative Report to appropriate law enforcement agencies. The Investigative Report described \$87,479.07 in improper or unsupported transactions.
 - Over 300 personal purchases – \$30,000+
 - State court -- 2018 Plea Agreement/Conviction
 - Former Superintendent pleaded guilty to five counts of theft by swindle, thirteen counts of embezzlement of public funds, and one count of receiving stolen property (19 counts in all).
 - Sentence: 24 months in jail and restitution of \$25,674.

Internal Controls for Credit Card Claims

- Governing board may authorize use of a credit card by an officer/employee otherwise authorized to make a purchase.
- If an officer/employee makes a credit card purchase that is not approved by the governing board, “the officer or employee is personally liable for the amount of the purchase.”
- Credit card purchases must otherwise comply with all statutes, rules, or policies applicable to the entity’s purchases.
- The employee should submit the (electronic or paper) itemized receipt from the point of sale to support payment, if possible.
- Include the specific vendors, not just credit card company, on claims approved by the governing board.
- *See e.g.* Minn. Stat. §§ 375.171 (Counties); 471.382 (Cities, Towns); 123B.02 (School Districts).

Fraud – Examples

- Payroll and Vendor (Business Email Compromise) Phishing/Spear Fishing Wire Transfer Fraud attempts
 - May be an email purporting to be from an employee or vendor
 - May be a change request – new bank account for payment
 - Scammer may have specific information on the employee or vendor
 - Now, with tech like AI, fake documents like invoices can be very convincing!

FBI – Internet Crime Complaint Center

www.ic3.gov

- The Internet Crime Complaint Center, or IC3, is the Nation's central hub for reporting cyber crime.
- It is run by the FBI, the lead federal agency for investigating cyber crime.
- The FBI aggregates complaints and makes referrals to local law enforcement and can sometimes freeze assets for asset recovery.

FBI – Internet Crime Complaint Center

www.ic3.gov

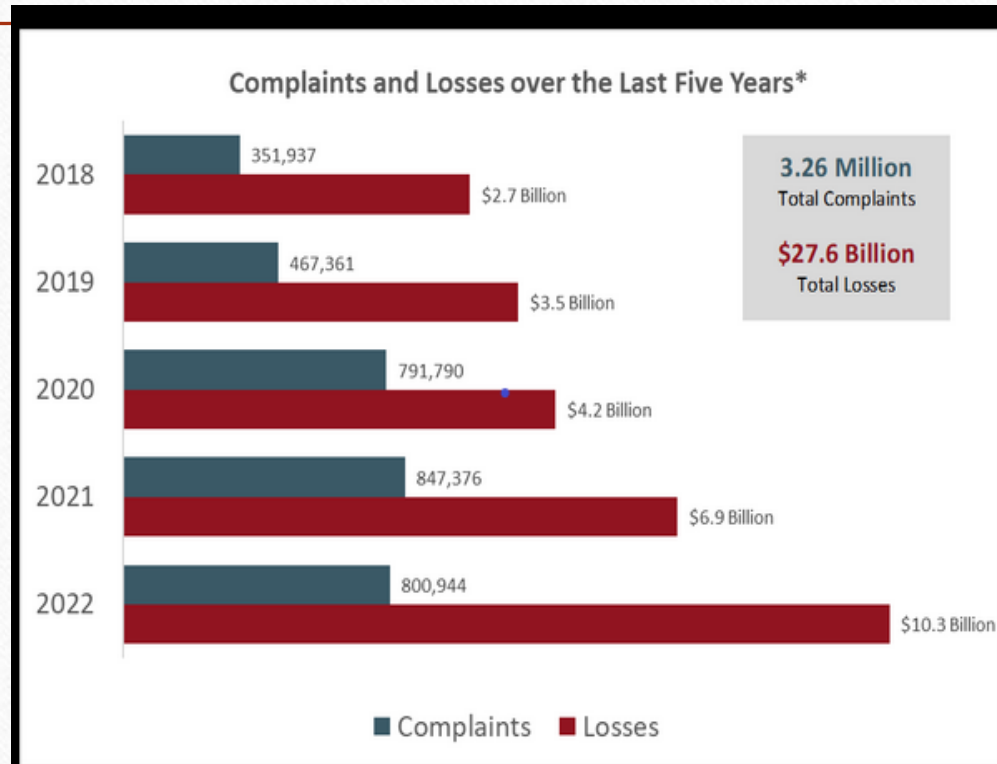


Chart includes yearly and aggregate data for complaints and losses over the years 2018 to 2022. Over that time, IC3 received a total of 3.26 million complaints, reporting a loss of \$27.6 billion.

Payroll and Vendor Payment – Ideas for Internal Controls

- Verify each request by contacting the person directly -- in person, or using a phone number you can rely on.
- Require employees or vendors to provide an original signed ACH form; not an electronic form.
- Take ACH forms off the internet, and only provide them to an internal or external address on file.
- On an ACH form, require that the employee or vendor provide the previous bank routing and account number for verification.
- Require multiple approvals.
- *See also*, GFOA publications “Electronic Vendor Fraud” and “Bank Account Fraud Prevention.”

Statutory ETF Procedures

- Electronic funds transfer is the process of value exchange via mechanical means without the use of checks, drafts, or similar negotiable instruments. Minn. Stat. § 471.38, subd. 3.
- The statute sets out required procedures, applicable to counties since 2017. Minn. Stat. § 471.38, subds. 3 and 3a, (*see* 2017 Minn. Laws, ch. 52, § 1).

Example – Minnesota local government

- Check Fraud
- Minnesota Statutes, section 336.4-406
- *Stowell v. Cloquet Co-Op Credit Union*, 557 N.W.2d 567 (Minn. 1997).

Promptly Review Your Bank Statements

- Review the agreement with your financial institution. How long do you have to identify fraudulent items and mistakes?
- Each month (or more frequently), someone not involved with writing checks/making payments should reconcile the bank statement to records of claims approved.
- Implement Positive Pay. “Positive pay is the single best fraud prevention tool available.” Bank Account Fraud Prevention (GFOA).

Local Government Officers and Employees Reporting Requirement

Minn. Stat. § 609.456

- Political subdivision employee/officer who discovers evidence of theft, embezzlement, unlawful use or misuse of public funds or property
- Must *promptly* report to state auditor (in writing) and to law enforcement
- Identity of 609.456 reporter is private data (Minn. Stat. § 6.715, subd. 2)
- Reporting form is on OSA website

Gift Cards

The OSA recently published a Statement of Position on Use of Gift Cards.

- In general, it reviews two concerns:
 - 1) Gift cards are not a permissible method of disbursing public funds.
 - 2) Public entities are not permitted to give gifts

See <https://www.osa.state.mn.us/media/r0ylygl4/use-of-gift-cards.pdf>

Gift Cards

- Question have been asked about **employee recognition**
- Minn. Stat. Section 15.46 authorizes cities and counties to “operate a program of preventive health and employee recognition services for its employees...”
- We have always interpreted this statute as authorizing reasonable incentives to employees for wellness or recognition programs:
 - 1) Non-monetary benefits or cash (through a check),
 - 2) set up in advance to avoid characterization as a gift.

Gift Cards

- Receipt of cash (through a check) by an employee is almost always taxable. In-kind benefits may not be taxable.
- The Internal Revenue Service (IRS) treats gift cards as cash equivalents and therefore as monetary benefits.

Gift Cards

- IRS Publication 15-B “Employer’s Guide to Fringe Benefits” covers the taxability of employee benefits. According to this publication all employee benefits are taxable unless specifically excluded. Among the exclusions listed are “**Achievement Awards**”, however this publication states:

Gift Cards

- “The exclusion doesn’t apply to awards of cash, cash equivalents, gift cards, gift coupons, or gift certificates (other than arrangements granting only the right to select and receive tangible personal property from a limited assortment of items preselected or preapproved by you).”

Gift Cards

- Some “de minimis” benefits may also be excluded from income.
- However, the IRS states: “Cash and cash equivalent fringe benefits (for example, gift certificates, gift cards, and the use of a charge card or credit card), no matter how little, are never excludable as a de minimis benefit.” (Emphasis added.)

Gift Cards

- So, any gift cards given to employees would fail both the “Achievement Award” and “de minimis” exceptions; and most likely be income to the employee, with withholding and reporting requirements for the employer.

Gift Cards - Conclusion

- If set up in advance, cities and counties can provide non-monetary incentives or rewards as part of an employee recognition program.
- They can provide monetary awards in the form of a check, but the amount will generally be taxable to the employee and subject to withholding and reporting by the government employer.
- However, monetary incentives or awards may not be paid to employees in the form of gift cards.

Thank You!

Office of the State Auditor

525 Park Street, Suite 500
St. Paul, Minnesota, 55103

Mark Kerr, JD, CFE
Special Investigations Director
(651) 296-4717
Mark.Kerr@osa.state.mn.us

