



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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MEMORANDUM FOR ALL FEDERAL, STATE, AND LOCAL GOVERNMENTS (FSLG)
MANAGERS AND EMPLOYEES

FROM: Paul A. Marmolejo, Director /s/ *Paul A. Marmolejo*
Federal, State and Local Governments

SUBJECT: Identification and Development of Fraud on Government and Non-Government
Entities.

Purpose

This memorandum issues guidance to FSLG Field Specialists (Specialists) to identify fraudulent activities and to develop fraud referrals on government entities or Fraud Development Leads (FDLs) on related parties such as employees, officers and vendors. The identification, development and prosecution of criminal tax cases are critical part of tax administration and compliance and help us ensure that everyone is paying their fair share of taxes. Specialists can play a key role in exposing fraud within government entities, which helps protect taxpayer resources and maintains public confidence in the fairness of the tax system.

Procedures

Generally, FSLG examines employment taxes of government entities. However, if there is fraudulent activity, it is generally committed by individuals, not the government entity itself. Therefore, when conducting examinations, Specialists should expand their scope of review to consider the potential for fraud committed by employees, officers and vendors who work for or with the government entity as they may be the only Service employee with access to information that is evidence of fraudulent activity. If Specialists uncover potential fraud in the government entity or with related parties, they need to first contact their group manager, fraud group SME (Subject Matter Expert) and FSLG Fraud Coordinator to determine the next step, which may include working with a Fraud Technical Advisor (FTA) and partnering with other divisions (i.e. SB/SE, LB&I, etc.).

The identification and development of fraud begins with planning the examination and continues throughout the examination. During an examination, there are three basic areas Specialists should strongly focus on to detect fraud: pre-audit techniques, initial interview and internal controls. Enhanced techniques in these areas will help lead Specialists to identify badges of fraud which may be present. A fraud detection “Job Aid” has been prepared to provide techniques and procedures to assist Specialists in these three areas. This Job Aid includes a vast array of tools, including expanded initial interview questions, pre-audit procedures, lead sheets to use as work papers, and scenarios with some audit techniques that may help identify the scheme during the examination.

Pre-audit techniques including internet research should be conducted in every examination. This will help Specialists to identify and request the necessary information in the initial Information Document Request and to develop thorough initial interview questions to probe any inconsistencies noted during the pre-audit research. There are many external and internal databases, such as Google, Yahoo, and IDRS the Specialist may use as well.

In addition to the standard initial interview questions, additional questions to help detect fraud should be incorporated in all initial interviews. The additional questions can be found in the Job Aid. These questions provide the taxpayer the opportunity to inform Specialists about fraud they previously discovered or to alert Specialists to relationships, or situations where the misappropriation of public funds may have occurred. Specialists should also conduct a thorough evaluation of internal controls to identify weaknesses where funds may be misappropriated. Detailed procedures for evaluating internal controls are contained in the Job Aid. Per IRM 4.90.8, the evaluation of internal controls is mandatory in each examination and should be part of the decision-making process when selecting the scope and appropriate audit techniques. Additionally, comments on the effectiveness of internal controls must be made in the work papers.

Indicators of fraud or fraud development leads (FDL) may need to be further developed through the use of additional research of internal sources of information, such as, but not limited to CBRS, and IDRS. Group Fraud SMEs are authorized to conduct this research on individuals and entities when indicators of fraud have been identified. Complete the Case Research Request Form, included in the Job Aid, citing a business reason for requesting the information. This form must be signed by the group manager. Under no circumstances should Specialists make third-party contacts regarding individuals or entities that are not open in their inventory.

The Job Aid contains a:

- Require Filing Checks/Package Audit Lead Sheet – a guide to completing these requirements, which contains a section on Fraud.

- Developing Indicators of Fraud Lead Sheet - a more extensive lead sheet to guide you in developing indicators of fraud and narrowing the scope to focus the examination.

Reporting Fraud without established Examination

If a Specialist is contacted by an individual or given information asserting allegations of potential wrong doing by a non-government entity or individual, encourage the individual to provide a written statement, offer to take down the information and complete Form 5666, *TEGE Referral Information Report*, with the information, and forward to the Referral Coordinator in CPM; or refer the individual to the Whistleblower Website at <http://www.irs.gov/compliance/article/0,,id=180171,00.html>. If the information is related to a government entity, record the information, complete Form 5666 and send to the Referral Coordinator in CPM. In the above situations, do not ask probing questions, make third-party contacts or request any documentation which may be construed as an examination.

Development of the FSLG Fraud Program

During the past year, FSLG incorporated Interim Guidance Memo 42 into IRM 25.1.9.7, conducted CPE training on fraud issues, and worked with SB/SE Fraud Technical Advisors (FTAs) and SBSE/BSA Fraud Analysts to improve procedures for referring FDLs to SB/SE.

For the remainder of FY 2012 and beyond, FSLG is committed to continue improving the FSLG Fraud Program by moving the majority of the content of IRM 25.1.9.7 into FSLG's own Fraud IRM 4.90.15 and adding additional fraud guidance.

Effect on Existing Guidance

This memorandum and additional guidance on the FSLG Fraud Program will be contained in new IRM 4.90.15. No existing IRMs are modified by this memorandum.

The fraud Job Aid is an attachment to this memo and will be reviewed in FY 2012 CPE session. The FSLG Fraud Program is a work in process and continues to evolve as issues and questions arise. It is imperative that we work together to develop a strong fraud program in FSLG. If you have questions or need additional information, please contact Jo Ann Lacey, FSLG Fraud Coordinator, at 512-499-5067.

Attachment: Fraud Development Job Aid