



Inspector General
Jeffrey E. Schanz

FRAUD ALERT
08-02-JS

TO: Executive Directors

FROM: Jeffrey E. Schanz
Inspector General 

SUBJ: Preventing Employee Embezzlement; New Hotline Poster; Improving Communications and Customer Service

DATE: December 17, 2008

The purpose of this Fraud Alert is to inform you about a recent embezzlement so you can be aware of the facts of this case and hopefully prevent a similar situation from arising in your program, to provide you with a copy of the OIG's new Hotline poster and to inform you about improvements in how you can report to my office.

Employee Embezzlement

Several months ago, my office was informed that a trusted employee managed to embezzle around \$200,000 from an LSC-funded program through a series of transactions that went undetected for several years. The embezzlement began to come to light when an employee working on a changeover in accounting systems noticed a different year-end close-out balance between the old and the new accounting systems. Rather than ignoring or excusing the discrepancy, the employee tried to reconcile the different amounts and noticed a check payable to a vendor in one amount but then paid for a much higher amount. The corresponding bank statement information and check were missing so the program requested a complete copy of the bank statement. With this information, the program discovered that the questioned check had been negotiated by a program employee, not by the program vendor. It turned out that the individual who was responsible for preparing the checks and reconciling the bank statements was making the checks out to herself and depositing them into her personal account.

A subsequent, more detailed review calculated that the employee embezzled roughly \$200,000 of program funds to pay for personal expenses, primarily by writing checks from the program

payable to herself, using the program's debit card and credit card for cash withdrawals and personal purchases, and using the program's general bank account to pay for her personal credit cards via electronic payment. The employee managed to complete the fraudulent check drafting process by having access to the necessary signature stamp. The employee also had sole access to the program's debit card and credit card, which allowed her to make unlimited withdrawals and purchases, and sole access to the program's online banking system, which enabled her to pay her credit card charges and go undetected.

It appears there were at least four internal control breakdowns which enabled this crime to occur:

1. Bank statements were not being properly reconciled. Initially a part-time accountant was responsible for reconciling the bank statements, but it appears the accountant did not do an adequate job. After the part-time accountant resigned, the suspect became responsible for reconciling bank statements.
2. The program allowed two accounting systems to run concurrently for far too long, which enabled the suspect to show vendor payments on one system and then draw checks payable to herself on the other.
3. The suspect was given too much trust and authority and not enough oversight. In fact, because the suspect had so much trust, at least one witness expressed reluctance to raise questions about the suspect's activities with program management.
4. All accounting duties were controlled exclusively by one employee, instead of being duly separated. Here, the suspect was permitted to exercise complete dominion over all program accounting functions such as access to the signature stamp, checking writing, and bank statement reconciliations.

All these internal control breakdowns not only led to the program being defrauded, but also enabled a trusted employee to do something that now may land her in jail.

Having an adequate system of internal controls is the responsibility of program management. Breakdowns in those controls can be very costly, as evidenced by the aforementioned case. Please ensure that you take appropriate steps to reconcile financial records, supervise your staff, and take appropriate security measures such as securing check stock and signature stamps. These and other steps may not eliminate but will help to prevent and detect fraud.

Hotline Poster

The statutory mandate of my office is to promote efficiency and effectiveness in the activities of LSC programs and operations and to prevent and detect fraud, waste, and abuse, protecting taxpayer dollars so that funding is used to provide legal services to those who need it. To accomplish this directive, we maintain a Hotline to facilitate the reporting of complaints of fraud, waste, and abuse, or violations of the LSC Act or regulations. Complaints may be received directly from LSC and LSC grantee clients, employees, and contractors, or from the general public.

As part of my effort to improve communication, cooperation and coordination with grantees, I am enclosing copies of the OIG's new Hotline poster that is intended to provide information to you, your staff, clients and others who want a convenient and confidential way to report actual or potential fraud, waste, abuse or violations. Please display these posters in prominent places, including break or lunchrooms and client waiting areas, as part of your system of internal controls. In addition to the posters, I also am enclosing an OIG Hotline Information Sheet that provides you with more guidance about the Hotline.

Improving Communications and Customer Service

There appears to have been some confusion in the past regarding what should be reported to the OIG, when it should be reported, and who at the OIG should be contacted. I would like to improve communications under the recently revised LSC Grant Assurances¹ by requesting the following:

- Please report all actual or suspected fraud, waste, abuse, or violations, not just those required under the Grant Assurances. When in doubt, contact the OIG, which has an experienced professional staff of auditors and investigators that can assist you. The OIG will keep you informed and advise you of the results of any inquiry into matters you report to us.
- Please be aware that once you determine that a reportable event has occurred, you must report to the OIG before conducting your own investigation. Also, unless you have an emergency that requires contacting other law enforcement agencies, please contact the OIG first.
- Your initial point of contact should be the OIG Hotline. In addition to contacting the Hotline, if you also wish to speak to someone on my senior staff, please contact Joel Gallay, Special Counsel, at 202-295-1666.

¹ The recently revised LSC Grant Assurances provide that programs must notify the OIG by telephone (OIG hotline: 800-678-8868 or 202-295-1670) within two (2) work days of the discovery of any information that gives it reason to believe it has been the victim of a loss of \$200 or more as a result of any crime, fraud, misappropriation, embezzlement, or theft or loss of property, client funds, LSC funds, as well as non-LSC funds used for the provision of legal assistance; or when local, state, or federal law enforcement officials are contacted by the program about a crime.

- To improve OIG customer service, I have directed my staff to contact you within two business days of receiving your report. If you do not hear back from the OIG, or in the event you have any other reason to speak to me personally, I am always available to take your call at 202-295-1677.

My staff and I are committed to improving communications and customer service so we can be more responsive to your concerns and more effectively prevent and detect fraud, waste, abuse, and violations.

Conclusion

Finally, I wanted to take a moment and thank you and your colleagues who attended the OIG's seminar at this year's NLADA conference. The session was a valuable opportunity for me to hear from the grantee community and to address your concerns. I look forward to continuing a dialogue with you in our efforts to provide high quality legal services to the poor.

Thank you for your time and attention and I hope you find this Fraud Alert useful. Of course if you have any questions please also feel free to call me directly at 202-295-1677 or email me at js@oig.lsc.gov.

Attachments (Hotline Posters; Hotline Information Sheet)