



Office of Inspector General
Legal Services Corporation

Inspector General

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FRAUD ALERT 20-0115-A-FA

TO: Executive Directors

FROM: Jeffrey E. Schanz
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SUBJECT: Payroll Fraud and Contemporaneous Timekeeping

The Office of Inspector General (OIG) for the Legal Services Corporation (LSC) is issuing this Fraud Alert to provide LSC grantee Executive Directors information obtained through OIG investigations involving payroll fraud, which generally occurs when employees wrongfully manipulate a payroll system to receive payments they have not earned. By means of this Fraud Alert, the OIG hopes to increase grantees' awareness of common types of payroll fraud and thereby assist you in preventing and detecting such frauds in the future.

Payroll is generally the largest expense for nonprofit organizations. Moreover, the Association of Certified Fraud Examiners has estimated that payroll fraud occurs in 27 percent of businesses, with the average payroll fraud incident lasting approximately 24 months. Investigations reveal that it is often long-term, trusted employees who initiate payroll fraud, and they usually target organizations with lax or non-existent internal controls.

This Fraud Alert will focus on two common types of payroll fraud: timesheet fraud and Fair Labor Standards Act (FLSA) misclassification fraud (i.e., misclassification of exempt employees as non-exempt under the FLSA and therefore eligible for overtime pay). Grantees should also be aware of other types of payroll fraud, however, including the use of ghost employees; fraudulent pay-rate alterations; padding of work hours; and employee salary advances that are never re-paid to the grantee.

Case Example 1: False Timesheets and Contemporaneous Timekeeping

An OIG investigation found that a former LSC subgrantee supervisor submitted false timesheets to receive pay for hours not worked over a 20-month period. In order to support the false timesheets, the supervisor entered false contemporaneous time entries in the subgrantee's case management system (CMS).

The supervisor submitted timesheets which claimed fraudulent work hours for times when the employee was taking classes towards her master's degree, studying for the bar, recovering from a medical procedure, or on vacation. The subgrantee's lax payroll policies and practices allowed the supervisor to enter and approve her own work hours, providing for no oversight over the hours the supervisor entered for herself prior to payment.

The applicable subgrant agreement required the supervisor to enter contemporaneous time records into the CMS in accordance with LSC's Timekeeping Requirement (45 C.F.R. Part 1635). The OIG investigation revealed the supervisor had made false contemporaneous entries into the CMS to support her fraudulent timesheets, claiming time for fictitious work activities as long as six weeks after they purportedly occurred.

Following the OIG's investigation, the former supervisor entered into a pre-trial diversion agreement with federal prosecutors, was required to make full restitution to the subgrantee, and was placed on supervised probation for one year.

Case Example 2: Falsely Misclassified Non-Exempt Status to Inflate Timesheets

An OIG investigation found that, during a four-year period, the top fiscal officer of an LSC grantee intentionally misclassified herself as non-exempt under the FLSA in order to add inflated overtime and extra hours to her timesheets. The employee's predecessor was classified as exempt, but the newly hired fiscal officer intentionally classified herself as non-exempt without approval from the executive director or board of directors.

The OIG investigation found no supporting documentation for over 3,000 of the fiscal officer's overtime and related workhours. The employee claimed work hours for weekends and holidays; misused leave hours; and for several 15-hour workdays. The employee was able to falsely claim this time because she was the sole person entering time for all grantee employees (including herself) and the executive director was not required to approve or review timesheets before the fiscal officer or other employees were paid. This case resulted in the fiscal officer's termination and a significant questioned cost which the grantee had to repay to LSC.

The Importance of Contemporaneous Timekeeping

Part 1635 requires all grantee attorneys and paralegals keep contemporaneous time related to each case, matter, or supporting activity. Some grantees have extended this requirement beyond attorneys and paralegals, requiring most staff to record their work activities contemporaneously in their CMS. The OIG has found that requiring staff to keep contemporaneous time records tends to deter employees who may consider inflating their timesheets, travel expenses, or other expense reports, or engaging in the outside practice of law.

Even when a contemporaneous timekeeping requirement fails to deter employees from inflating timesheets or falsifying travel expenses, the resulting false contemporaneous time reports will often assist grantees in detecting, investigating, and holding employees responsible for fraud after the fact.

Best Practices

1. Establish policies for timekeeping and payroll that ensure sufficient separation of duties for timekeeping approval and payroll processing.
2. Utilize a payroll system that allows supervisors to review, track, and authorize overtime and leave requests.
3. If financially feasible, outsource your payroll function to a reputable vendor (doing so may also provide improved efficiency and flexible service options).
4. A payroll processor should never be responsible for entering changes or amending employee payroll records.
5. Require employees to affirm on their timesheets that the time and attendance data they are submitting are true, correct, and accurate.
6. Require supervisors to submit timesheets to payroll after affirming through signature that they have reviewed them for accuracy. Do not allow employees to submit their own timesheets to payroll; require review for all timesheets.
7. Require vacations. Employees processing payroll should be required to take five continuous days of leave at least once a year.
8. A supervisor should be required to review and approve any changes to an employee's pay rate or FLSA status (i.e., exempt vs non-exempt).
9. Know the law regarding exempt vs non-exempt FLSA classifications and ensure all grantee employees are correctly classified.
10. Reconcile the check register against payroll records each month.
11. Change passwords and login credentials in the payroll system whenever there is a personnel change in the payroll department, including when an employee departs from the program.
12. Reduce the risk of stolen or altered paper checks by requiring direct deposit of employee pay.
13. When cash advances have been made, monitor re-payments on a monthly basis.

14. In order to identify timekeeping anomalies and irregularities, schedule periodic audits/reconciliations of timesheets and CMS time entries by someone outside of the payroll department.
15. Periodically utilize the CMS timekeeping audit function to determine whether staff is recording time contemporaneously as required by LSC and the grantee's policy.
16. Require employees to immediately report incidents of payroll fraud to management and to the OIG.

This Fraud Alert is provided to assist you in protecting your program funds from fraud, waste and abuse. Timely reporting such matters to the OIG when they occur can further help protect grantee funds.

We hope you find this Fraud Alert useful, and we encourage you to distribute it to your staff. In addition, we welcome requests for OIG training, which is designed to increase awareness of potential fraud indicators at LSC programs.

The OIG's Fraud Hotline telephone number is 800-678-8868 or 202-295-1670; our email address is hotline@oig.lsc.gov; and our fax number is 202-337-7155.

If you have any questions concerning this Fraud Alert, please contact Dan O'Rourke, Assistant Inspector General for Investigations, LSC OIG, at 202-295-1651 or dorourke@oig.lsc.gov.