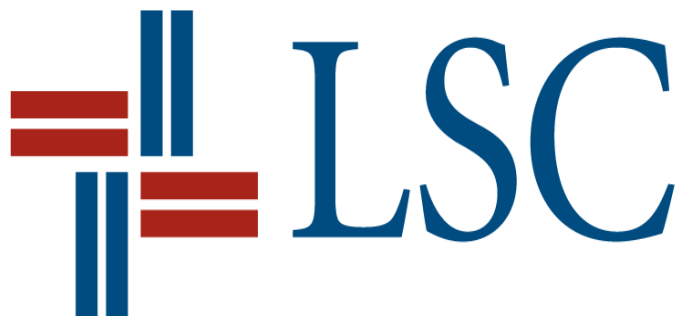


**LEGAL SERVICES  
CORPORATION**

Office of  
Inspector General



Semiannual Report to the Congress  
October 1, 2008 – March 31, 2009

[www.oig.lsc.gov](http://www.oig.lsc.gov)



May 27, 2009

The Honorable Edward M. Kennedy, Chairman  
Committee on Health, Education, Labor and Pensions  
United States Senate  
428 Dirksen Senate Office Building  
Washington, DC 20510

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Helaine M. Barnett

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Dear Chairman Kennedy:

The Office of Inspector General (OIG) of the Legal Services Corporation (LSC) has completed its Semiannual Report for the period October 1, 2008 to March 31, 2009. We are transmitting the Report to Congress as required by law, along with this Management Response containing additional information. The LSC Board of Directors concurs with the presentation of statistics in Tables I and II of the Report.

Congress entrusts LSC with a dual mission: to promote equal access to justice and to provide high-quality civil legal assistance to low-income Americans. In fulfillment of that mission, LSC funds 137 nonprofit programs with 923 offices serving every Congressional district in the nation.

The Board, prompted by two Government Accountability Office (GAO) reports, has concentrated its efforts over the last two years to bring its governance practices into alignment with Sarbanes/Oxley principles, to improve its oversight of the Corporation's financial and compliance responsibilities, and to focus the Corporation's attention on improved internal cooperation and good management practices. In making these efforts, the Board has had the assistance of and complete cooperation from the Corporation's management and the OIG. LSC provided a May 2008 update and an August 2008 final report to the GAO documenting the substantial completion of all of the recommendations made in the two GAO reports. We also note that the OIG made some recent recommendations on the administration of the Sunshine Act. The Board is considering steps to take to address the issues raised by the OIG and has requested further input from the OIG and the Corporation's General Counsel to assist it in resolving the matter.

The Board and LSC management are pleased that the OIG found that the programs under review as a result of the GAO report have, for the most part, corrected the issues specifically identified by the GAO in December 2007. However, the OIG also found “additional problems that in many cases had greater financial implications than the deficiencies identified by GAO.” The OIG concluded “that while these issues did not constitute a systemic problem, because the issues were individually significant our findings evidenced the need for continuing dedication in the area of grant oversight.” The Board fully agrees and we intend to work with LSC management and the OIG in order not only to resolve these individual issues but also to endeavor to assure that issues such as these do not arise in the future.

For this reporting period, the OIG identified six audit reports that remained open. In response to two audits, LSC’s Office of Compliance and Enforcement will conduct questioned costs proceedings (one is underway at one program and another soon will be initiated at another program). Currently, information regarding grantees’ action in response to two other reports has been submitted for the OIG’s consideration as to whether the findings can be closed out. As to the fifth audit, the grantee reported that it planned to complete responsive action by June 2009.

The sixth audit report listed by the OIG is LSC’s annual outside audit, which was issued as a final report in January 2009. We are pleased to note that for the fifth consecutive year, LSC received an opinion from outside auditors that LSC's financial statements present fairly, in all material respects, the financial position of LSC. Resolution of a matter identified by LSC’s outside auditors and referred to in the sixth audit report awaits receipt of an outside opinion by a law firm which is providing LSC with pro bono assistance.

The Board and LSC management continue to appreciate the work of the OIG and, in particular, the efforts of LSC Inspector General Jeffrey E. Schanz, who joined the Corporation in March 2008. He provides LSC with Management Information Memoranda (MIMs), which are timely reports that offer opportunities to take appropriate action where necessary. Two MIMs were issued during the reporting period to which LSC management has already responded.

We thank you and the Congress for the bipartisan support provided to LSC. For fiscal 2009, LSC received an appropriation of \$390 million, and increases in federal funding are more important than ever before because of budget shortfalls in the states and because of projected declines in funds from Interest on Lawyer’s Trust Accounts.

Equally important is the proper use of the funds entrusted to our stewardship. We consider that stewardship to be a central mission of the LSC Board and LSC management. LSC will keep Congress apprised of the progress made in strengthening internal financial controls and grants oversight.

Honorable Edward M. Kennedy  
May 27, 2009  
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If you or your staff have any questions or desire further information, please contact John Constance, Director, Government Relations and Public Affairs, at 202-295-1611, or me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Frank B. Strickland". The signature is stylized and cursive.

Frank B. Strickland  
Chairman

Attachment

**TO THE BOARD OF DIRECTORS OF THE LEGAL SERVICES CORPORATION  
AND TO THE UNITED STATES CONGRESS**

**A MESSAGE FROM THE INSPECTOR GENERAL**

I am pleased to submit this report on the activities and accomplishments of LSC's Office of Inspector General (OIG) for the period October 1, 2008 through March 31, 2009.

A major focus of our efforts during this period was the completion of work following up on a Government Accountability Office (GAO) review of LSC's controls over grant management and oversight. We issued audit reports on the final three in a series of eight internal control reviews at grantees identified in the original GAO report. We also provided LSC management with an overview memorandum, summarizing the findings and issues identified in the course of all our reviews in the series. Overall, in these reviews we reported on issues affecting more than \$1.4 million, of which \$435,000 was referred to management as questioned costs.

Two other audit reports were issued during the period, including the LSC corporate audit for fiscal 2008. As part of our oversight role with respect to the grantee audit process, the OIG also conducts quality assurance reviews of the work of selected grantees' independent public accountants. We issued three such audit service review (ASR) reports.

The OIG opened 21 new investigations, and closed 16 investigations this reporting period. As part of our emphasis on preventive efforts, we continued to conduct on-site fraud vulnerability assessments for grantees, and issued a fraud alert to all executive directors to highlight issues and vulnerabilities identified in the investigation of a \$200,000 embezzlement from an LSC-funded program.

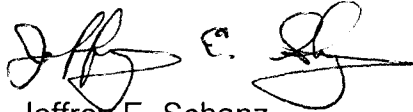
We issued two Management Information Memoranda to bring to management's attention issues regarding grantee compliance with LSC and IRS regulations. We also issued a special Board Advisory Memorandum concerning apparent violations of the Government in the Sunshine Act in connection with the fall 2008 Board of Directors meeting.

With this report I have completed my first full year as LSC's Inspector General. I have been impressed by the ability and dedication of the OIG staff and the way they have responded to the challenges presented to them. I am very gratified at the contributions we have been able to

make, and am committed to continuing to do all that we can to help improve and protect LSC's programs.

I would like to express my deep appreciation to the Board of Directors, LSC management, and to the Congress, for their support of the important work of this office.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jeff E. Schanz', with a stylized flourish at the end.

Jeffrey E. Schanz  
Inspector General  
April 30, 2009

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## OFFICE OF INSPECTOR GENERAL OVERVIEW

The LSC Office of Inspector General operates under the Inspector General Act of 1978, 5 U.S.C. App. 3. In 1988, Congress amended the IG Act and required LSC and about 30 other, mostly smaller, federally funded entities to establish independent Offices of Inspector General.

The OIG has two principal missions: (1) to assist management in identifying ways to promote economy and efficiency in the activities and operations of LSC and its grantees; and (2) to prevent and detect fraud and abuse. Thus, the OIG assists management in fostering effective operations, in identifying and overcoming obstacles to good program management, and in preventing future problems. The OIG must also identify and report on current problems.

The OIG's primary tool for achieving these missions is objective and independent fact-finding, performed through financial and other types of audits, evaluations and reviews, and through investigations into allegations of wrongdoing. Its fact-finding activities enable the OIG to develop recommendations to LSC, Congress, and grantee management for actions or changes that will correct problems, better safeguard the integrity of funds, improve procedures, or otherwise increase the economy, efficiency and effectiveness of LSC programs.

The OIG is also tasked with ensuring the quality of audits of LSC and its grantees, conducted by independent public accountants, and with reviewing proposed and existing regulations and legislation affecting the operations and activities of LSC and the programs it funds.

In addition, since 1996 LSC's annual appropriations have directed that grantee compliance with legal requirements be monitored through the annual grantee audits conducted by independent public accountants, under guidance developed by the OIG. Congress has also specified that the OIG has authority to conduct its own reviews of grantees.

The OIG is headed by the Inspector General who reports to and is under the general supervision of the LSC Board of Directors. The IG has broad authority to manage the OIG, including setting OIG priorities and activities, and to hire OIG personnel, consultants, and experts.

To ensure objectivity, the IG Act grants the LSC IG independent authority to determine what reviews are performed; to gain access to all documents needed for OIG reviews; to publish findings and recommendations based on OIG reviews; and to report OIG findings and recommendations to the LSC Board of Directors and to Congress. The IG Act also prohibits LSC from assigning to its IG any of LSC's own "program operating responsibilities." This means that the



OIG does not perform functions assigned to LSC by the Legal Services Corporation Act, 42 U.S.C. §§2996 *et seq.*, other than those transferred to the OIG under the IG Act, and those otherwise assigned by Congress, for example in LSC's annual appropriations acts.

The IG must report serious problems to the LSC Board of Directors and must also report to appropriate law enforcement authorities when, through audit, investigation, or otherwise, the IG has found that there are reasonable grounds to believe that a crime has occurred. The OIG is not an "arm" of the Congress, as is the Comptroller General, but is required by law to keep the Congress informed through semiannual reports and other means. The IG also provides periodic reports to the Board and management of LSC, and occasionally to the boards of directors and management of LSC grantees. Some of these reports will be specific (*e.g.*, an audit of a particular grantee or an investigation of a theft or embezzlement), while others will be of broader application or of more general interest to management.

To be effective, the OIG works cooperatively with the Board and management, seeks their input prior to choosing topics for OIG review, and keeps them informed of OIG activities. Within their different statutory roles, the OIG and LSC management share a common commitment to improving the federal legal services program and increasing the availability of legal services to the poor.

## AUDITS

In this reporting period, the OIG issued five audit reports. Three of the reports were the last of a series of reports addressing LSC management's request that the OIG follow up on the Government Accountability Office's report on LSC's controls over grant management and oversight. In addition to the three reports, the OIG issued a memorandum summarizing the overall findings for all eight grantee audits that we conducted in response to LSC management's request. The other two reports issued this period were the LSC corporate audit for fiscal year 2008, conducted by an independent public accounting firm, operating under contract to and general oversight by the OIG, and a report on selected internal controls at an LSC grantee.

In addition to completing the above-noted audits, during the period the OIG initiated an audit of contracting policies and controls at LSC headquarters, and an audit of selected internal controls at another grantee.

Fulfilling its responsibility for overseeing the independent public accountant (IPA) audits performed at each grantee, the OIG conducted five Audit Service Reviews. These reviews are designed to ensure that the work conducted by the independent public accountants meets applicable professional standards and is in accordance with the instructions issued by this office.

The OIG also issued an Audit Bulletin clarifying that IPAs are required to report whether the recipient's internal control systems provide reasonable assurance that the recipient is managing funds, regardless of source, in compliance with federal laws and regulations. This guidance conforms to the language of Section 509(a) of LSC's 1996 appropriations act, which has been incorporated by reference in all subsequent LSC appropriations acts, and is effective for audits with fiscal years ending June 30, 2009, and later.

During the period the OIG also underwent a peer review, conducted by the Office of the Special Inspector General for Iraq Reconstruction. Such a review is required every three years under generally accepted government auditing standards (GAGAS). The OIG received an "unmodified opinion," which means the review found that the OIG's quality control system for audits was designed adequately and was functioning as prescribed, thus providing reasonable assurance that GAGAS were met. The review team did identify some areas that will help strengthen the OIG's audit operation. All recommendations were agreed to and have been or will be implemented.

Additionally, pursuant to a request by the Council of the Inspectors General on Integrity and Efficiency, the OIG initiated a peer review of the Amtrak OIG. Again, the objective of this review is to ensure that the Amtrak OIG has an

internal quality control system adequately designed and functioning to meet GAGAS. This project is on-going.

## **Audits of Selected Internal Controls at Grantees**

### **GAO Follow-up Audits**

As a result of a request from the President of LSC, the OIG agreed to follow up on the internal control weaknesses found at eight of the nine grantees that were identified in the course of GAO's review of LSC's grants management and oversight. (Report GAO-08-37, *Legal Services Corporation – Improved Internal Controls Needed in Grants Management and Oversight*, December 28, 2007.) In addition to the internal control issues identified in the GAO report, the OIG reviewed other internal controls over financial and administrative areas as deemed appropriate. The results of the final three of our series of eight reports are presented below.

### **Legal Services NYC**

Our review found that Legal Services NYC management had taken appropriate steps to address the issues raised by GAO by implementing controls over the future use of grant funds for alcohol purchases and lobbying fees. The OIG did find that recordkeeping for legislative activities could be improved. This finding was acted upon by grantee management during the course of the audit, thus no recommendation was necessary. Additionally, the OIG found that while action had been taken to reduce the payment of late fees, some late fees were still being incurred. The OIG also found that the factors used to allocate indirect costs among grants may need to be updated and the allocation system needed to be documented. Grantee management agreed to take further action to prevent the incurrence of late fees, and to update and document the grantee's cost allocation system.

### **Legal Aid and Defender Association, Inc. (Detroit)**

The OIG found that issues raised in the GAO report still existed at Legal Aid and Defender Association (LAD). Specifically, we found that the information technology (IT) contract originally reported on by GAO did not reflect the grantee's current IT situation and resulted in payments exceeding the contract terms; that travel expenses were not adequately documented; and that LSC funds were used to purchase alcohol. In addition to the issues raised by GAO, the OIG found that:

- LSC funds were used for mortgage payments, requiring the grantee to either establish a formal reversionary interest for LSC in the property or repay LSC for all LSC funds used in purchasing the building;
- The intake staff did not inquire about callers' citizenship or alien status during telephone intake screening, contrary to LSC regulations;
- Some cost reallocations were not adequately supported; and
- Allocations of indirect costs were not adjusted at year end for actual charges.

As a result, over \$273,000 of questioned costs were referred to LSC management for action.

Grantee management took actions to address most of the findings in the OIG audit report and implemented internal controls to detect such issues and prevent them from occurring in the future. However, some actions were not sufficient to correct the deficiencies. These findings and recommendations were referred to LSC management for resolution. In particular, grantee management actions did not adequately address the issues identified with the IT contract and documenting travel expenses. While changes were made to the IT contract, the changes did not adequately ensure that grantee funds were protected and that expenses charged to LSC were supported and reasonable. In addition, the grantee did not require that individuals submit a travel expense report for all travel, travel advances, and travel related expenses, nor did it require that unused travel advances be repaid if planned travel did not occur.

Grantee management did establish controls to ensure that all expenditures are properly allocated to the proper funding source and implemented a policy to prohibit the use of grant funds to purchase alcohol. Also, grantee management reallocated to non-LSC funds the mortgage payments that triggered an LSC interest in the property. This action was taken in lieu of recording a reversionary interest as would have been required by the LSC Property Acquisition and Management Manual for property purchased in part with LSC funds. The grantee also retrained staff and reconfigured the citizenship question on their case management system to ensure that intake screeners asked applicants their citizenship/alien status. At fiscal year end grantee management adjusted indirect costs for the various funding sources to that year's actual cost, and revised their Accounting Manual to require yearly readjustment of indirect costs.

As the OIG determined that the grantee's corrective actions were not sufficient in response to certain findings – matters pertaining to the IT contract, establishing procedures to ensure that payments for services or goods do not exceed agreed upon prices, and internal controls over travel – these recommendations remain

open and were forwarded, along with the associated questioned costs, to LSC management for action.

Although the OIG determined that the grantee's actions do fully address the problems of (1) the purchase of alcohol with LSC funds, and (2) inadequately described and documented general journal entries, the questioned costs associated with these findings were referred to LSC management. Therefore, these recommendations remain open as well.

### California Indian Legal Services

The OIG's review disclosed that California Indian Legal Services (CILS) did not have an Accounting Manual in place. (An Accounting Manual is expressly required by the LSC Accounting Guide and applicable grant assurances.) As a result, the CILS system of internal control could not be assessed to determine if it was adequate to protect the organization's assets or ensure that transactions were properly recorded. Accordingly, the OIG could not determine if adequate internal controls were in place and working as designed to prevent the use of grant funds to purchase alcohol or incur late fees, issues identified by GAO in its earlier review. Without the availability of the grantee's Accounting Manual, the OIG was unable to fully assess the operation of controls over employee benefits and reimbursements, disbursements, and internal management reporting/budgeting.

While disbursements were adequately supported in all but 5 of the 84 payments reviewed, the OIG was unable to fully determine whether all the disbursements tested were allowable and properly allocated to LSC funds. This was because the allocation system was not fully documented and grantee personnel could not provide an accurate description of the allocation process during the onsite visit. In addition to the lack of some supporting documentation, the OIG found eight instances where disbursements were coded to be charged to a shared account but were actually charged to LSC funds without any explanation for the change in coding. The OIG identified instances where costs were wholly allocated to LSC that should have been shared with other funding sources. The OIG found that two payments were made to an employee totaling over \$23,830, portions of which were charged to LSC funds. Because the payments to the employee were part of a fee-for-service program, the OIG questioned whether any of the costs should have been charged to LSC funds. The OIG questioned whether the total cost for rooms, food, and conference facilities for a tribal conference, amounting to \$39,798, should have been charged only to LSC funds. These costs included a \$6,384 charge for unused rooms. The OIG referred a total of \$79,254 in questioned costs to LSC management for review.

Grantee management planned action to complete a new Accounting Manual. The OIG views this as responsive to the findings because it will improve the

internal control structure needed to help ensure that issues such as those raised in this report are prevented or detected. The OIG disagreed with the grantee's comments on assigning direct costs to specific grants. Grantee management indicated that they were not tracking direct costs and would continue to record direct costs as shared expenses. Under LSC requirements, direct costs that can be identified to a specific grant should be charged to that grant. This disagreement was forwarded to LSC management for resolution.

### Conclusion of GAO Follow-Up Audits / Summary Memorandum

This period, with the audits discussed above, the OIG completed its series of audits following up on control issues identified in the GAO report. To further assist management, the OIG issued a memorandum summarizing the findings for all eight audits and identifying matters for LSC management's consideration. The OIG concluded that, except in a few instances, the issues specifically identified by GAO had been sufficiently corrected at each of the eight grantees visited. The major exception reported was a contracting issue at the Detroit grantee; that matter has been referred to LSC management for follow-up action.

However, we noted that we also found problems at some grantees that were not identified by GAO. In our review of the eight grantees, the OIG found issues pertaining to not properly recording derivative income; purchasing property with LSC funds without establishing LSC's reversionary interest in the property; various disbursements that were not fully documented or should not have been charged to LSC funds; problems with allocation systems for apportioning costs to the various grants, including the LSC grant; and operating without an Accounting Manual, a required element of a grantee's internal financial control system.

In total, the OIG reported on issues affecting \$1,477,658 in LSC or LSC-derivative funds, of which \$435,000 was referred to management as questioned costs. We noted that while many of the issues were not recurrent with each of the grantees, the number and magnitude of the issues tended to reinforce GAO's original findings of "potential control deficiencies at grantees that could have been detected with more effective oversight." Our reviews found additional problems that in many cases had greater financial implications than the deficiencies identified by GAO. We concluded that while they did not constitute a systemic problem, because the issues were individually significant our findings evidenced the need for continuing dedication in the area of grant oversight to ensure such issues do not go undetected.

## **Audit of Selected Internal Controls at Legal Services of Greater Miami, Inc.**

This was an OIG-initiated audit, not part of our series of GAO follow-up reviews. The audit found that the selected internal controls reviewed at Legal Services of Greater Miami were adequate as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability, and compliance with LSC regulations. Grantee disbursements tested were adequately supported, allowable, and appeared to be properly allocated to LSC funds. The OIG found that controls over the general intake process were sufficient. Internal controls over compliance with specific LSC regulations were adequate. Although the OIG's review of internal controls over employee benefits and reimbursements revealed that the controls were generally adequate, the OIG noted that controls could be strengthened by developing formal policies in three areas: advance pay for employees not covered by the collective bargaining agreement; the use of grantee-issued cell phones; and the procedures for securing services either through consultant contracting or the use of temporary staff.

Grantee management agreed with our recommendations and has taken corrective action.

## **FY 2008 Corporate Audit**

The FY 2008 LSC financial statement audit report was issued this reporting period and transmitted to the LSC Board of Directors. The Corporation's financial statement audit is conducted by an independent public accounting firm under contract to and general oversight by the OIG. The OIG reviewed the work of the IPA and found it in compliance with generally accepted government auditing standards. The *Independent Auditors' Report* stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2008 and 2007, and the results of its operations and changes in its fund balance for the years then ended. The *Independent Auditors' Report on Compliance and Other Matters* identified an issue with the classification of certain workers as independent contractors rather than employees. The report stated that LSC has not taken appropriate steps to ensure it is in compliance with Internal Revenue Code §3121 and related laws and regulations. LSC management stated that it plans to take action to address this issue.

**Audit Reports**

Open at beginning of reporting period.....2  
Issued during reporting period.....5  
Closed during reporting period.....1  
Open at end of reporting period.....6

**Recommendations to LSC Grantees**

Pending at beginning of reporting period.....2  
Issued during reporting period.....25  
Closed during reporting period.....10  
Pending at end of reporting period.....17

**Recommendations to LSC Management**

Pending at beginning of reporting period .....0  
Issued during reporting period.....1  
Closed during reporting period.....0  
Pending at end of reporting period.....1

**Independent Audits of Grantees**

Since 1996, LSC’s annual appropriations acts have required that each person or entity receiving financial assistance from the Corporation be subject to an annual audit, to be conducted by an independent public accountant in accordance with generally accepted government auditing standards and guidance established by the OIG. Each grantee contracts directly with an IPA to conduct the required audit in accordance with generally accepted government auditing standards, and the OIG Audit Guide for Recipients and Auditors and Compliance Supplement, which incorporates some requirements of OMB Circular A-133.



While these audits are not performed by the OIG, the OIG does provide guidance to the IPAs and oversees the IPA process. The OIG reviews all audit reports prepared by the IPAs each year, and performs on-site quality reviews of selected IPAs' documentation.

The OIG also works with management through an audit follow-up process to ensure that adequate action is taken to address all significant findings identified in IPA reports and referred to LSC management. LSC's annual appropriations acts have specifically required that LSC follow up on significant findings identified by the IPAs and reported to the Corporation's management by the OIG.

In order to provide more complete information in our semiannual reports to Congress, we include a summary of significant findings and the status of follow-up on significant findings reported by the IPAs as part of the grantee oversight process. The audit reports and the findings identified below reflect the work of the IPAs, not the OIG.

### **Follow-up Process**

Recipient audit reports are submitted to the OIG within 120 days of the close of the recipient's fiscal year end. The OIG reviews the report and any related findings and recommendations. Based on this review, the OIG refers appropriate findings to LSC management for follow-up.

LSC management ensures that recipients submit corrective action plans for all material findings, recommendations, and questioned costs identified by the IPAs and referred to management.

After corrective action has been taken by the recipient, LSC management advises the OIG and requests that the finding be closed. The OIG reviews management's request and decides independently whether it will agree to close the finding. If LSC management and the OIG cannot agree on closing a finding, the matter is entered into a resolution process for final determination.

### **Review of Grantees' Annual Audit Reports: IPA Audit Findings**

During the reporting period, the OIG reviewed 23 IPA audits of grantees with a fiscal year end of January 31, 2008 through September 30, 2008. These audit reports contained seven findings. The OIG determined that all seven findings were significant and referred them to LSC management for follow-up.

The tables below present information on the 23 recipient audit reports reviewed this period (recipients with fiscal years ending January 31, 2008 through September 30, 2008).

**Summary of Findings Reported in Recipient Financial Statement Audits**

Total Number of Findings Referred.....	7
Number of Findings with Corrective Action Accepted by LSC Management.....	4
Number of Findings Awaiting LSC Management Review.....	3

**Types of Findings Referred to LSC Management for Follow-up**

Category	Number of Findings
Internal Controls Weaknesses in Financial Transactions and Reporting	4
Trial Balance Errors Resulting from Incorrect Configuration of Accounting Software	1
Written Policies/Procedures Needed for Accounting Function	1
Untimely Reconciliation of Accounts and Closing Steps	1
Total	7

**Audit Service Reviews (ASRs)**

As described above, the OIG is responsible for the oversight of the IPAs who are selected by the grantees to perform their annual financial and compliance audits. To fulfill this responsibility, the OIG conducts Audit Service Reviews, which are reviews of the audit documentation of selected IPAs to ensure that they adequately tested the grantee’s compliance with LSC regulations. During this period, the OIG issued five ASR reports.

## INVESTIGATIONS

The OIG opened 21 investigations during this reporting period. These included 13 criminal investigations, five compliance matters, and three fraud vulnerability assessments. The criminal investigations included allegations of financial fraud and thefts of property from LSC programs. The compliance investigations included allegations of violations of LSC statutes and regulations involving matters such as retaliation and representing ineligible clients. During the reporting period the OIG closed 18 investigations. These included nine criminal investigations, five compliance matters, three fraud vulnerability assessments, and a project to enhance Hotline operations. The OIG also issued one Inspector General subpoena in connection with an ongoing investigation.

### **Fraud Alert Issued to Executive Directors**

During this reporting period, the OIG issued a fraud alert to all grantee executive directors to highlight issues related to an investigation where a trusted employee embezzled approximately \$200,000 from an LSC-funded program through a series of transactions that went undetected for several years. The embezzlement came 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. The employee tried to reconcile the different amounts and noticed a check shown as 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 was discovered 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 revealed that the employee embezzled roughly \$200,000 of program funds to pay for personal expenses.

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

1. Bank statements were not being properly reconciled.
2. The program allowed two accounting systems to run concurrently for far too long, which enabled the subject to

show vendor payments on one system and then draw checks payable to herself on the other.

3. The subject was given too much trust and authority and not enough oversight.

4. Perhaps the single most important factor was that a fundamental principle of internal control – separation of duties – was not practiced here.

The Fraud Alert noted that all these internal control breakdowns led to the program being defrauded. 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 reported case. Grantees were requested to ensure that they take appropriate steps to reconcile financial records, supervise their staff, and take appropriate security measures.

The OIG will continue to issue periodic alerts advising recipients of LSC grant funds about fraudulent schemes and activities in an effort to help limit the opportunities for them to recur.

### **Fraud Vulnerability Assessments**

During this reporting period the OIG completed two fraud vulnerability assessments (FVAs) initiated during the prior period, and conducted three new assessments. The FVAs consist of a fraud awareness briefing to the grantee's executive director and chief financial officer; a focused document review in areas identified as weak or prone to abuse; and a review of grantee internal control policies versus practices. These reviews help surface both existing and potential problem areas; improve managers' awareness of their fiscal responsibilities; and serve as a deterrent by making staff aware that funds are subject to review.

The two prior period assessments completed during this reporting period found no indicators of fraud. Of the three FVAs opened this reporting period, one is complete and two are pending the final Report of Investigation. The FVA completed during this reporting period found no indicators of fraud. Of the two remaining FVAs opened during this reporting period, one FVA found a weakness in the process of handling vendor receipts. Final results from the remaining two FVAs will be reported in the next reporting period.

Past OIG investigations at grantee sites involved funds stolen from petty cash, and fraudulent activity involving travel and mileage expenses, credit card accounts, payroll/salary advances, and grantee vendor accounts. Reviews of the programs affected often disclosed that while the nominal internal control policies appeared adequate for the size of the program, a breakdown in following those

policies and applying the controls facilitated the embezzlements. (The case depicted in our most recent fraud alert, described above, is a paradigm example of what can happen under such circumstances.) By briefing grantee managers on indicators of and any potential vulnerabilities to fraud and embezzlement, the OIG hopes to assist them in detecting early warnings of such problems.

### **Management Information Memoranda Issued to LSC Management**

The OIG issued two Management Information Memoranda to LSC management as a result of information developed during investigations. These are described in detail in the section “Other OIG Activities,” at page 18.

### **Hotline**

The OIG maintains a Hotline for reporting illegal or improper activities by LSC grantees or Corporation staff. For this reporting period, the OIG received 46 Hotline contacts (compared to 27 the previous reporting period). Of these matters, one was referred to LSC’s Office of Government Relations and Public Affairs; four were referred to LSC’s Office of Compliance and Enforcement for follow-up; six were either opened as investigations within the OIG or related to ongoing investigations; and the remaining matters were closed.

The OIG has continued working to improve Hotline operations to make contacting us easier and to encourage the reporting of potential fraud, waste, and abuse in LSC programs and operations. As previously reported, our toll-free Hotline number (800-678-8868) was changed to help direct callers seeking information about getting legal assistance to LSC’s main telephone number (202-295-1500). We also reported that we added two additional ways to contact the Hotline: by e-mail ([hotline@oig.lsc.gov](mailto:hotline@oig.lsc.gov)) and by fax (202-337-7155).

During this reporting period, we sought to further publicize the OIG Hotline by printing and distributing an attractive Hotline poster. The poster was distributed to all LSC grantees, as well as within LSC headquarters. We received several commendations for our effort and numerous requests for additional posters. Along with these efforts we can report that quantitatively overall OIG Hotline activity increased by over 70% and that qualitatively we have been receiving more calls resulting in investigations and fewer calls relating to requests for legal services, which previously represented the largest number of callers.

## **INVESTIGATIVE CASES**

Open at beginning of reporting period	21
Opened during reporting period	21
Closed during reporting period	18
Open at end of reporting period	24

## **PROSECUTORIAL ACTIVITIES**

Referred for prosecution	1
Accepted for prosecution	1
Declined for prosecution	0
Indictments	1
Convictions	0

## **INVESTIGATIVE ACTIVITIES**

Inspector General subpoenas issued	1
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## **LEGAL REVIEWS**

### **Review of Proposed Legislation, Regulations, and Policy**

Pursuant to the IG's statutory responsibilities, the OIG reviews and, where appropriate, comments on statutory and regulatory provisions affecting LSC and/or the OIG, as well as LSC interpretive guidance and internal policies and procedures.

During this period, the OIG reviewed and, where appropriate, provided comments on 14 legislative, regulatory, and policy matters. The more significant items are discussed below.

On October 14, 2008 the Inspector General Reform Act of 2008, Pub. L. 110-409, was signed into law. Following enactment of the IG Reform Act, the OIG's legal staff worked closely with other members of the IG legal community in an ongoing effort to address needed technical changes to the IG Act relating to hotline anonymity; IG website requirements; and IG payments to the newly-created Council of the Inspectors General on Integrity and Efficiency.

Also during the period, the OIG commented on LSC's preliminary analysis of rulemaking in the area of lesser or intermediate sanctions for noncompliance with statutory and regulatory restrictions. With respect to LSC policies and procedures, the OIG commented on revisions made by LSC management to the LSC Supervisor's Manual.

### **Litigation Activities**

As noted in previous Semiannual Reports, in 2006 the OIG issued an interim report on the activities of California Rural Legal Assistance (CRLA), finding substantial evidence that CRLA had violated federal law and regulations governing LSC grantees. The OIG could not complete its investigation due to CRLA's refusal and/or failure to respond to an OIG subpoena seeking information relevant to the investigation.

In March 2007, the U.S. Department of Justice (DOJ) filed a subpoena enforcement petition in the United States District Court for the District of Columbia. In August 2008, following resolution of a number of procedural issues, the district court heard arguments on the petition. At the request of the district court, the parties subsequently agreed to attempt to resolve their differences through mediation. Mediation proved unsuccessful. The DOJ and the OIG subsequently submitted to the court a new proposal to resolve all outstanding

disputes concerning CRLA's compliance with the subpoena. Briefing on this proposal is underway. If the proposal is accepted (or CRLA otherwise complies with the subpoena), the OIG will be able to resume and complete its investigation.

### **Board Advisory Memorandum Issued**

The OIG issued a Board Advisory Memorandum as a result of work performed by OIG counsel. This is described in detail in the section "Other OIG Activities," at page 19.

### **Other Activities**

During this reporting period, the OIG responded to six Freedom of Information Act requests. OIG counsel produced eight formal legal opinions during the period.



## OTHER OIG ACTIVITIES

### Management Information Memoranda

The OIG issues Management Information Memoranda (MIMs) when we believe that issues uncovered in the course of ongoing OIG work should be brought promptly to management's attention, so that management may consider taking immediate corrective action. This period the OIG issued two MIMs, as follows.

#### Management Information Memorandum – *Quid Pro Quo* Contributions

The OIG issued a MIM based on our investigation of an allegation that an LSC grantee provided up to two administrative days off per year, as determined by the executive director, to attorneys and management staff who contributed at least \$100 and to all other staff who contributed at least \$50 to the annual fundraising Equal Justice Campaign. The grantee provided individual letters to its staff contributors thanking them for their donation, acknowledging the total amount donated, and advising that the letter be retained as proof of the charitable contribution for federal tax purposes.

Under the Internal Revenue Code, 26 U.S.C. §6115, and applicable IRS rules, charitable organizations like LSC grantees must provide a written disclosure statement to donors of a *quid pro quo* contribution in excess of \$75. The statement must provide the donor with the amount of the donation as well as a good faith estimate of the value received by the donor. While the grantee's letter to staff contributors acknowledged the total amount of their donation, the letter did not provide staff with a good faith estimate of the value of the administrative leave they received in exchange for their donation. Additionally, the letter did not inform staff that the amount of their deduction was limited to the amount of the donation over the value of the time off, as required.

The OIG recommended that LSC advise grantee programs of their obligations to be aware of and in compliance with IRS rules if they participate in this type of *quid pro quo* fundraising activity because violations of §6115 carry monetary penalties which could diminish limited program resources. The OIG also recommended that LSC advise grantee programs to ensure that they generally comply with applicable federal laws and regulations.

In response, LSC management stated that they would advise grantees of their obligations as recommended by the OIG.

## Management Information Memorandum – Restricted Activities; §1635.3(d) Certifications

A MIM was issued after OIG investigations at three separate LSC grantees indicated non-compliance with 45 C.F.R. § 1635.3(d), which generally requires that any attorney or paralegal who works part-time for a grantee and part-time for an organization that engages in restricted activities, certify in writing on a quarterly basis that they have neither engaged in restricted activity during any time in which they were compensated by the grantee nor used any grantee resources toward their restricted activities.

Our investigations revealed that two grantees failed to obtain completed certification forms from all their part-time attorneys and paralegals, as required. In addition, many of the certifications that were obtained were filed well after the end of each quarter. These findings demonstrated a need for programs to become more vigilant in collecting complete and timely data from part-time attorneys and paralegals as required to comply with §1635.3(d), and to help ensure that scarce program resources are not expended improperly.

Additionally, another grantee did not require its part-time attorneys to submit quarterly certification forms based on its view that, because they worked as private practitioners and not for “an organization” (the term used in the regulation), they were not subject to the certification requirements of §1635.3(d). We observed that this interpretation appeared contrary to the intent of the certification requirement, which aims to ensure that limited LSC resources are not used for restricted activities.

The MIM recommended to management that LSC’s Office of Compliance and Enforcement review compliance with §1635.3(d) during all future program visits and periodically confirm whether grantees have submitted complete and timely quarterly certification forms. Additionally, we recommended that in light of the grantee’s alternative interpretation of §1635.3(d), LSC should clarify the rule.

### **Board Advisory on Apparent Sunshine Act Violations**

During the period, the OIG issued a Board Advisory Memorandum discussing the application of the Government in the Sunshine Act, 5 U.S.C. §552b, to the LSC Board of Directors’ November 1, 2008 meetings, and concluding that LSC appeared to have violated its regulations and the Sunshine Act by holding portions of its meetings in closed session; by not maintaining the transcripts of the closed session meetings at the Corporation; and by not making the transcripts promptly available to the public, as required. We recommended the Board seek review of the matter by the Corporate Secretary/General Counsel and, subject to his conclusions, take corrective action.

## **Congressional Requests**

In February 2009, the OIG responded to two Congressional requests. We provided information, in response to specific inquiries, regarding: possible Sunshine Act and/or LSC by-law violations; issues relating to the Technology Initiative Grants (TIG) program; contracting practices at LSC, including contracts with current program employees; travel outside the continental United States by LSC headquarters staff; and locality pay. The OIG's fiscal year 2009 work plan already included reviews of both LSC contracting practices and the TIG program, and these areas will be addressed further in future reports. We will also be providing a supplemental response on non-US travel.

## **Efficiency Recommendation**

The OIG reported to management that LSC was not receiving favorable GSA-schedule pricing on its off-site records storage contract and recommended an initiative that LSC implemented and that is estimated to save LSC a minimum of \$4,000 per year.

## **OIG Administrative Manual**

The OIG developed and issued a formal Administrative Manual to all OIG employees. The Manual serves as a guide for the day-to-day administration of the OIG by defining responsibilities, standards of professional and ethical conduct, and organizational structure. Further, it sets out OIG policies and practices to safeguard assets, standardize administrative processes, enhance operational efficiency, and define support services provided by the Corporation. It is supplemental to the LSC Administrative Manual and Employee Handbook, applicable to all LSC personnel.

**AUDIT REPORTS ISSUED  
for the Period Ending March 31, 2009**

Report Title	Date Issued	Questioned Costs	Funds Put to Better Use	Unsupported Costs
FY 2008 LSC Corporate Audit	01/28/09	\$0	\$0	\$0

Reports on Selected Internal Controls:

Legal Services NYC	12/11/08	\$0	\$0	\$0
Legal Aid and Defender Association, Inc.	02/05/09	\$273,054	\$0	\$0
California Indian Legal Services	03/27/09	\$79,254	\$0	\$0
Legal Services of Greater Miami, Inc.	03/31/09	\$0	\$0	\$0

**AUDIT SERVICE REVIEWS ISSUED  
for the Period Ending March 31, 2009**

Recipient	IPA	Date Issued
Community Legal Aid Services	Barnes Wendling, CPAs	10/30/08
Mid-Missouri Legal Services Corp.	Marberry, Miller & Bales	11/06/08
Nevada Legal Services, Inc.	Ellsworth, Gilman, Johnson & Stout	11/11/09
Pro Bono Legal Services	Johnston, Marion & Co.	03/09/09
Legal Aid Society of Cleveland	Barnes Wendling, CPAs	03/31/09

## TABLE I

### Audit Reports Issued with Questioned Costs for the Period Ending March 31, 2009

	NUMBER OF REPORTS	QUESTIONED COSTS	UNSUPPORTED COSTS
A. For which no management decision has been made by the commencement of the reporting period.	0	\$0	\$0
B. Reports issued during the reporting period	2	\$352,308 <sup>1</sup>	\$0
Subtotals (A + B)	2	\$352,308	\$0
LESS:			
C. For which a management decision was made during the reporting period:	0	\$0	\$0
(i) dollar value of recommendations that were agreed to by management	0	\$0	\$0
(ii) dollar value of recommendations that were not agreed to by management	0	\$0	\$0
D. For which no management decision had been made by the end of the reporting period	2	\$352,308	\$0
E. Reports for which no management decision had been made within six months of issuance	0	\$0	\$0

<sup>1</sup> On February 20, 2009 the OIG referred to LSC management questioned costs in the amount of \$273,054 found in the audit, *Report on Selected Internal Controls – Legal Aid and Defender Association, Inc.* On March 31, 2009, the OIG referred to LSC management \$79,254 in questioned costs found in the audit, *Report on Selected Internal Controls – California Indian Legal Services.* These two issues of questioned costs await resolution.

## TABLE II

### Audit Reports Issued with Funds to Be Put to Better Use for the Period Ending March 31, 2009

	NUMBER OF REPORTS	DOLLAR VALUE
A. For which no management decision has been made by the commencement of the reporting period.	0	\$0
B. Reports issued during the reporting period	0	\$0
Subtotals (A + B)	0	\$0
LESS:		
C. For which a management decision was made during the reporting period:	0	\$0
(i) dollar value of recommendations that were agreed to by management	0	\$0
(ii) dollar value of recommendations that were not agreed to by management	0	\$0
D. For which no management decision had been made by the end of the reporting period	0	\$0
Reports for which no management decision had been made within six months of issuance	0	\$0

## TABLE III

### Index to Reporting Requirements of the Inspector General

IG ACT REFERENCE*	REPORTING REQUIREMENT	PAGE
Section 4(a)(2)	Review of legislation and regulations	16
Section 5(a)(1)	Significant problems, abuses, and deficiencies	None
Section 5(a)(2)	Recommendations with respect to significant problems, abuses, and deficiencies	None
Section 5(a)(3)	Prior significant recommendations on which corrective action has not been completed	None
Section 5(a)(4)	Matters referred to prosecutive authorities	15
Section 5(a)(5)	Summary of instances where information was refused	None
Section 5(a)(6)	List of audit reports by subject matter, showing dollar value of questioned costs (including a separate category for the dollar value of unsupported costs) and funds to be put to better use	21
Section 5(a)(7)	Summary of each particularly significant report	4-8, 19
Section 5(a)(8)	Statistical table showing number of audit reports and dollar value of questioned costs	22
Section 5(a)(9)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use	23
Section 5(a)(10)	Summary of each audit issued before this reporting period for which no management decision was made by the end of the reporting period	None
Section 5(a)(11)	Significant revised management decisions	None
Section 5(a)(12)	Significant management decisions with which the Inspector General disagrees	None

\*Refers to sections in the Inspector General Act of 1978, as amended.