



SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION

January 28, 2009

The Honorable Jeffrey E. Schanz
Office of Inspector General
Legal Services Corporation
3333 K St NW
Washington, DC 20007-3558

Re: Peer Review of LSC OIG's Audit Function

Dear Mr. Schanz:

As requested by the President's Council on Integrity and Efficiency (PCIE), we have reviewed the system of quality control for the audit function of the Legal Services Corporation (LSC) Office of the Inspector General (OIG) in effect for the year ending March 31, 2008. A system of quality control encompasses an OIG's organizational structure and the policies and procedures established to provide it with reasonable assurance that the OIG is conforming to generally accepted government auditing standards (GAGAS¹). The elements of a quality control system are described in GAGAS, which is issued by the Comptroller General of the United States. The standards state that OIGs are responsible for designing and complying with their control systems in all material respects. Our objective was to determine whether the LSC OIG's designed and implemented internal quality control system provides reasonable assurance that applicable auditing standards, policies, and procedures have been followed. The standards require that based on our review, we express an opinion on the adequacy of the system's design and the OIG's compliance with the system.

Based on our review we are issuing an unmodified opinion. According to the PCIE guidance, an unmodified opinion should be issued when the review team finds that a quality control system is designed adequately and is functioning as prescribed and thus has yielded reasonable assurance that GAGAS was met. At the same time, we identified a number of areas in audit quality assurance and audit guidance that could be strengthened. The OIG generally concurred with our observations and recommendations, and we therefore consider all peer review matters closed. The agency's complete response to the draft report appears as Exhibit C.

Our review was conducted in accordance with the guidelines established by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency. In performing our review, we gained an understanding of the OIG's system of quality control. In addition, we tested compliance with the OIG's quality control policies and procedures to the extent we considered appropriate and adequate to meet our objectives. These tests included the

¹ *Government Auditing Standards*, 2003 Revision, which was effective for the period being reviewed.

application of the OIG's policies and procedures on selected audits: three performance audits conducted in-house and one financial statements audit conducted by an independent public accountant and monitored by the OIG. Typically, a peer review covers the 1-year period of the OIG's last two semiannual reports. However, the OIG had issued only one report on a performance audit conducted in-house during that period. Accordingly, to have a sufficient universe of performance audits from which to sample, we expanded the scope of our review to include the last six semiannual periods. This period covers the 3-year period April 1, 2005, through March 31, 2008. Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of the lack of compliance with it. Nevertheless, we believe that the procedures we used provide a reasonable basis for our opinion. We discuss in more detail how we performed our work in Exhibit A, Scope and Methodology.

Departures from the system may occur and not be detected because any system of quality control has inherent limitations. Also, the projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

Unmodified Opinion

In our opinion, the system of quality control for the audit function of the LSC OIG in effect for the year ended March 31, 2008, was designed to meet the requirements of the quality control standards established by the Comptroller General of the United States for a federal government audit organization and was complied with during the year ended to provide the OIG with reasonable assurance of generally conforming with applicable auditing standards, policies, and procedures.

We noted, however, conditions that warrant your attention even though they did not impact our opinion. As discussed in more detail in the Findings and Recommendations section of this report, we noted the following three overall conditions:

- The three performance audits that we reviewed had minor deviations from OIG's fieldwork and reporting policies and procedures and GAGAS.
- The OIG has not conducted periodic internal quality control reviews of its audits even though it agreed to do so in its response to a prior peer review² finding and recommendation and after modifying its audit policies and procedures to require such a review.
- The OIG's audit policies and procedures have some gaps that create weaknesses in its quality control system.

During our peer review, we also noted that the LSC Board of Directors and management had in the recent past taken actions that could be viewed as attempts to unduly control, impede, or

² *National Railroad Passenger Corporation Peer Review Report on Office of Inspector General Legal Services Corporation*, August 5, 2005.

restrict the OIG's independence. While the number of audits performed by the OIG was limited, we found no evidence that the audits that we reviewed were adversely affected by the Board's actions. Moreover, the current IG has clearly indicated his intent to assert his statutory authority and is mindful of the protections to the OIG's organizational independence provided for by the Inspector General Act. Nevertheless, we documented this issue to fully describe the audit operating environment and as an issue for consideration under the next peer review. This issue is discussed in more detail in Exhibit B, General Comments.

Findings and Recommendations

Finding 1 – Minor deviations from fieldwork and reporting standards

The three performance audits that we reviewed had minor deviations from OIG's fieldwork and reporting policies and procedures and from GAGAS. The following provides the details of our fieldwork and reporting findings.

Working paper security:

The OIG's audit policies and procedures manual and GAGAS 7.69 require that working papers be adequately secured.

Initially, we were unable to determine whether one of the three performance audits met GAGAS fieldwork and reporting standards because documentation for planning and reporting on the audit, including documentation of the independent referencing process, was missing from the working papers. However, during the exit conference, the OIG provided copies of documentation showing that the referencing process was adequately completed and explaining that the original referencing documentation was misplaced.

Audit Planning:

The OIG's audit policies and procedures manual and GAGAS 7.07 require that the succeeding items be included in all audit plans.

Two of the three performance audits that we reviewed have audit plans that did not (1) identify the needs of potential report users, (2) document approval by management, (3) include audit steps to identify prior related audits, and (4) document why some audit steps were not completed.

Documentation and Evidence:

The OIG's audit policies and procedures manual and GAGAS 7.48 through 7.71 incorporate requirements for meeting the need for documentation and evidence.

Two of the three performance audits that we reviewed did not verify the reliability of computer-based data used to support findings, lacked documentation of sampling plans, and relied on testimonial evidence without attribution.

Statements on Internal Controls:

The OIG's audit policies and procedures manual and GAGAS 8.17 state that auditors should include in the audit report the scope of their work on internal controls.

One of the performance audit reports states that the audit included such tests of internal controls as considered necessary under the circumstances. However, the internal controls statements

should have included descriptions of the scope of the internal controls tested, such as citing the specific program regulations or procedures that were tested.

Recommendation 1

We recommend that LSC IG take action to reinforce with the audit staff the need to meet all GAGAS requirements and to provide training to all staff on the standards.

LSC OIG Response

The OIG concurs with our findings and said that it would take prompt action to implement the recommendation. The response states that, since his arrival in March 2008, the IG has made several policy and practice changes that address some of the issues identified, such as putting physical security controls in place for audit working papers. The response further states that the OIG will provide related periodic training and is developing a comprehensive checklist to be completed for each audit assignment that will ensure that all required items are included in the audit file. The checklist will also serve as a training device and will remind all staff to review their work to ensure that audit objectives are met and that GAGAS are consistently applied.

Finding 2 – Need to strengthen internal quality controls

GAGAS 3.50 states that an audit organization's internal quality control system should include procedures for monitoring, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied

The OIG has not conducted periodic internal quality control reviews of its audits although it agreed to do so in its July 26, 2005, response to a prior peer review finding and recommendation. The OIG had modified its policies and procedures to require the reviews, but they were not implemented. The organization's last peer review found that the OIG did not have an internal quality assurance program in place and recommended that one be established and that periodic reviews of audits be conducted. The OIG explained that the reviews were not conducted because of resource constraints and the lack of projects conducted under GAGAS requirements. Nonetheless, the OIG concurred with the finding and recommendation and incorporated policies and procedures for periodic quality reviews of audits into the office's audit manual effective September 1, 2005. However, the OIG has not performed the quality reviews since establishing the policies and procedures. OIG officials explained that they had not conducted the reviews because of limited staff resources and more critical work, such as responding to particular issues and information requests from Congress.

Our assessment of the OIG's audit staff resources and audit workload showed that staff resources were limited. The OIG's audit operation has only seven positions: three audit supervisors and four auditors. GAGAS 3.51 provides the following relief under such conditions:

“The nature and extent of an audit organization's internal quality control system depends on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its audit offices, the nature of its work, its organizational structure, and appropriate cost-benefit considerations. Thus, the systems established by individual audit organizations will vary as will the need for, and extent of, their documentation of the systems. However, each audit organization should prepare appropriate documentation for its system of quality control to demonstrate compliance with its policies and procedures. The form and content of such documentation is a matter of judgment. Documentation of compliance should be retained for a period of time sufficient to enable those

performing monitoring procedures and peer reviews to evaluate the extent of the audit organization's compliance with the quality control policies and procedures.”

Because we could not initially determine whether one of the three performance audits reviewed met GAGAS fieldwork and reporting standards due to missing documentation related to the independent referencing process, we believe that some level or form of periodic quality control review should be conducted.

Recommendation 2

We recommend that, given its limited staff resources, the LSC IG establish an alternate quality control process designed to ensure that the audit documentation includes evidence that the audit met GAGAS and modify its audit manual accordingly, consistent with GAGAS 3.51.

LSC OIG Response

The OIG agrees with the recommendation, stating that it appreciates the peer review team's recognition of the background and context in which the internal quality control program was established. The response further states that any significant deviations from policies will be documented in the future. Consistent with the recommendation, the OIG states that it will review current policy and establish an alternate quality control process as provided for in GAGAS 3.51.

Finding 3 – Gaps in audit policies and procedures

While the system taken as a whole provides reasonable assurance that the LSC OIG has complied with GAGAS in producing audit products, our review nevertheless, did identify some gaps in policy implementing guidance that create weaknesses in the OIG's quality control system. This is an opportune time for the OIG to ensure that its audit policies and procedures are effective, comprehensive, and complete considering that they need to be updated to reflect the 2007 revision of GAGAS.³ The following details the gaps in the policies and procedures.

Auditors' understanding of independence requirements

GAGAS 3.08 states:

“...audit organizations should include as part of their internal quality control system requirements to identify personal impairments and assure compliance with GAGAS independence requirements. At a minimum, audit organizations should:

- b. communicate the audit organization's policies and procedures to all auditors in the organization and assure understanding of requirements through training or other means such as auditors periodically acknowledging their understanding....”

The OIG's audit policy and procedures manual relies solely on auditors to report any personal independence issues in conducting an audit. However, no management controls are in place to ensure that auditors comply with the standard or to provide them guidance on impairment and independence issues. Internal quality control procedures are necessary to help determine whether auditors have any personal impairments to independence in conducting audits or performing nonaudit services and to ensure an understanding of the requirements through

³ *Government Auditing Standards, 2007 Revision.*

training or other means, such as auditors periodically acknowledging their understanding through a proactive declaration of independence.

Taking corrective action on the results of external peer reviews

GAGAS 3.52 states that an audit organization should take remedial, corrective actions as needed based on the results of peer reviews. Although the LSC OIG's audit manual identifies external quality control reviews as a component of its quality control program, it does not provide policies and procedures for taking remedial corrective action, as needed, on the results of such reviews.

Determine reputation and standing of independent public accountants

GAGAS⁴ require auditors to inquire about the professional reputation and standing of other auditors such as the independent public accountants (IPA) that the OIG hired to audit LSC's financial statements. The OIG's audit manual requires the project manager to review an auditor's qualifications but does not specifically require inquiries about an auditor's professional reputation and standing.

Terminating an audit

GAGAS 5.38 states:

"If an audit is terminated before it is completed but the auditors do not issue an audit report, auditors should write a memorandum for the record that summarizes the results of the work to the date of termination and explains why the audit was terminated. In addition, auditors should communicate the reasons for terminating the audit to management of the audited entity, the entity requesting the audit, and other appropriate officials, preferably in writing. This communication should be documented."

OIG's audit manual does not include policies and procedures for terminating an audit before it is completed.

Attestation engagements

GAGAS, Chapter 6, addresses attestation engagement standards. The LSC OIG manual does not have policies and procedures on planning, conducting, and reporting on attestations. Although the OIG's comments in PCIE's Appendix A, Section 1, questionnaire state that the OIG has not performed attestation engagements, LSC management's request that OIG review grantee internal controls may be considered an attestation engagement. The 2007 revision to GAGAS includes significant fundamental changes that further clarify attestation engagement standards.

Nonaudit services

GAGAS sections 2.14 through 2.16 and 3.10 through 3.18 contain 12 specific standards related to providing nonaudit services while protecting the organization's and an individual auditor's independence. Currently, the OIG's audit manual does not have policies and procedures for providing nonaudit services. Although the OIG's comments in PCIE's Appendix A, Section 1,⁵ questionnaire indicate that the OIG does not typically engage in nonaudit services, we have

⁴ AU Section 543.10 of the AICPA auditing standards is incorporated into GAGAS.

⁵ PCIE's *Guide for Conducting External Quality Control Reviews of the Audit Operations of Offices of Inspector General, Appendix A, Section 1*, questionnaire requests OIGs to provide the peer review team specific information about its policies and procedures designed to ensure compliance with generally accepted government auditing standards.

identified what appear to be nonaudit services provided by the OIG during our review period. Some examples we identified that appear to be forms of nonaudit services provided include:

- Inspections
- Audit Service Reviews
- Reviews of Grantees' Annual Audit Reports
- Management Alerts
- Advisory services to the LSC Board of Directors
- Regulatory Task Force
- Recommendations to Committee for 2007 Regulatory Agenda
- Report on Certain Fiscal Practices at LSC

Moreover, the 2007 revision to GAGAS contains significant new fundamental requirements that further clarify nonaudit services, the impact on auditors' independence, and enhanced requirements for a system of quality control that may be applicable to the LSC OIG.

Recommendation 3

We recommend that the LSC IG direct that the OIG's existing audit policies and procedures be completely revised by a timely date. In completing this revision, the OIG should identify and use best practices of other OIGs and tailor them to meet its operating environment consistent with GAGAS.

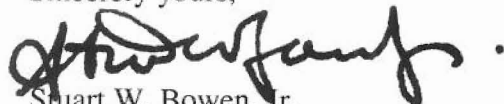
LSC OIG Response

The OIG agrees with our recommendation and asserts that it will implement it promptly. The response reiterates that upon his arrival the new IG addressed some of the issues identified by the review team, specifically with respect to auditors' understanding of the independence requirements, by issuing the *Legal Services Office of Inspector General Statement of Professional Standards*. Those standards amplify LSC's Code of Ethics and Conduct and address all impairments to independence as contained in GAGAS. Finally, the OIG states that it will review its audit manual and modify it as necessary.

SIGIR Response

The OIG's planned actions as noted above are responsive to our review's observations and recommendations and, if properly implemented, should address all matters raised during this peer review. We are encouraged that the OIG has completed or intends to complete all actions on our recommendations by April 30, 2009.

Sincerely yours,



Stuart W. Bowen, Jr.

Special Inspector General for Iraq Reconstruction

Exhibit A Scope and Methodology

SIGIR conducted its review of the LSC OIG's system of quality control in accordance with the guidelines established by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency. In performing our review, we obtained an understanding of the OIG's system of quality control. In addition, we tested compliance with the OIG's audit quality control policies and procedures and GAGAS⁶ to the extent we considered appropriate. These tests included the application of the OIG's policies and procedures on selected audits.

Typically, a peer review would have covered the 1-year period of the last two semiannual reports issued by the OIG to the Congress. However, because the OIG had issued only one report on a performance audit conducted in-house during that period, we expanded the scope of our review to include the last six semiannual reports covering the 3-year period April 1, 2005, through March 31, 2008, to have a sufficient universe of performance audits from which to select. During that 3-year period, the OIG issued nine audit reports: five performance audit reports conducted in-house by OIG auditors and four financial statement audit reports conducted by IPAs. We selected a sample of four audits to review: three performance audits and one financial statement audit. The audits selected included:

- *Financial Statements and Independent Auditors' Report*, September 30, 2006 and 2005, and June 2007.
- *Interim Report on Management Oversight of Grantees – Office of Program Performance*, Report No. AU07-02, April 2007.
- *Interim Report on Management Oversight of Grantees – Office of Compliance, and Enforcement*, Report No. AU06-02, March 2006.
- *Audit of LSC's Two Million Dollars (\$2,000,000) Landlord Contribution* Report No. AU05-06, June 2005.

⁶ *Government Auditing Standards*, 2003 Revision, which was effective for the period being reviewed.

Exhibit B General Comments

External actions could be viewed as attempts to unduly control, impede, or restrict OIG's organizational independence

During our peer review we noted that the LSC Board of Directors and management had in the recent past taken actions that could be viewed as attempts to unduly control, impede, or restrict the OIG's independence. The OIG's independence was also of concern to LSC's congressional oversight committee, which held hearings on the matter in September 2006. Independence is key to auditors' ability to ultimately form objective opinions and conclusions. The Inspector General Act and other OIG authorizing legislation⁷ provide statutory protections for independence as required by GAGAS 3.25.

GAGAS 3.03 states that the general standard related to independence is:

“In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public should be free both in fact and appearance from personal, external, and organizational impairments to independence.”

GAGAS 3.19 states:

“Factors external to the audit organization may restrict the work or interfere with auditors' ability to form independent and objective opinions and conclusions. External impairments to independence occur when auditors are deterred from acting objectively and exercising professional skepticism by pressures, actual or perceived, from management and employees of the audited entity or oversight organizations. For example, under the following conditions, auditors may not have complete freedom to make an independent and objective judgment, and an audit may be adversely affected:

- a. external interference or influence that could improperly or imprudently limit or modify the scope of an audit or threaten to do so, including pressure to reduce inappropriately the extent of work performed in order to reduce costs or fees;
- b. external interference with the selection or application of audit procedures or in the selection of transactions to be examined;
- c. unreasonable restrictions on the time allowed to complete an audit or issue the report;
- d. interference external to the audit organization in the assignment, appointment, and promotion of audit personnel;

⁷ Inspector General Act of 1978, as amended, Public Law 95-452, § 1, and Fiscal Year 1996 Legal Services Corporation Appropriations Act, Public Law 104-134.

- e. restrictions on funds or other resources provided to the audit organization that adversely affect the audit organization's ability to carry out its responsibilities;
- f. authority to overrule or to inappropriately influence the auditors' judgment as to the appropriate content of the report;
- g. threat of replacement over a disagreement with the contents of an audit report, the auditors' conclusions, or the application of an accounting principle or other criteria; and
- h. influences that jeopardize the auditors' continued employment for reasons other than incompetence, misconduct, or the need for audit services."

During the 3-year review period from April 2005 through March 2008, LSC had three Inspectors General, including one in an acting position. The first of the three served from September 2004 through September 2007. The second served as Acting Inspector General from September 2007 through February 2008 and is currently the Assistant Inspector General for Audit. The third and current Inspector General was appointed in February 2008. SIGIR identified actions of the LSC Board and management during those 3 years that could be viewed as attempts to unduly control, impede, or restrict the OIG's independence while it was auditing or investigating LSC expenditures and other transactions. Some of the OIG's work was being conducted at the request of LSC's congressional oversight committee. The following are examples of actions and congressional concerns about those actions that the LSC Board and management took:

- LSC management issued a 2006 Memorandum of Understanding (MOU) for an information-gathering protocol requiring that OIG requests for information be directed to the LSC General Counsel and that the Counsel deliver the information.
- In June 2006, the LSC Board proposed to rate the Inspector General, which was also a matter of concern addressed in a September 2006 hearing before LSC's congressional oversight committee, the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary, House of Representatives.
- A letter to LSC from the congressional oversight committee in April 2006 and a subsequent congressional hearing addressed concern that the Board was considering firing the prior Inspector General; likewise, the hearing examined the issue of efforts to impede the IG's independence, including testimony from the then-IG in that regard.

Impairments to independence can permeate all aspects of the OIG's audit activities, often with imperceptible adverse affects. However, we identified no audits that appeared to have been adversely affected, and we obtained evidence indicating that the prior Inspector General and current Inspector General were not intimidated by the Board's actions. The prior Inspector General was not reluctant to exercise his independence in conducting audits and reporting on them after the work was conducted or to act on matters that required management to be accountable for resolving audit issues. For example

- The prior Inspector General, having initially agreed to the MOU that restricted or limited direct access to records, shortly afterward rescinded the MOU as unworkable in an April 2006 memorandum to the Board.
- Further, in April 2006, based on concerns about possible efforts to fire him, the prior Inspector General reported the matter to the oversight committee and later testified in a hearing on the attempts by the Board to impede his independence. In response, the committee sent the Board the letter stating that it would be unwise to fire the Inspector General, who ultimately was not fired.

Our discussions with the current Inspector General and actions he has taken over his 8-month tenure indicate that he has asserted and intends to continue asserting the statutory authority and is mindful of the protections to the OIG's organizational independence provided for by the Inspector General Act. The Inspector General also said that the Board's recent formation of an Audit Committee should help to ensure independence. In addition, in the coming months, a new Board will be appointed by a new administration, the audit policy and procedures manual is expected to be revised to comply with the revised 2007 GAGAS,⁸ and our findings and recommendations on improving the audit policy and procedures could also be addressed at that time. Moreover, the recently amended Inspector General Act⁹ addresses the Inspector General's independence by, for example, requiring a 30-day advanced written notice to both the House and Senate of the intent to remove an Inspector General and the reasons for the action. Nonetheless, this environment makes it even more important that the OIG ensure compliance with GAGAS and adequately document the audit planning, execution, and reporting processes. Therefore, we are documenting our observations related to the independence issue to ensure that the future peer review team will be aware of them when planning and conducting its review.

⁸ *Government Auditing Standards*, July 2007 Revision.

⁹ Inspector General Reform Act of 2008, Public Law 110 -409.

Exhibit C
Legal Services Corporation, Office of Inspector General Response



Legal Services Corporation
Office of Inspector General

Inspector General
Jeffrey E. Schanz

January 21, 2009

The Honorable Stuart W. Bowen, Jr.
Special Inspector General for Iraq Reconstruction
400 Army Navy Drive
Arlington, VA 22202

Dear Mr. Bowen:

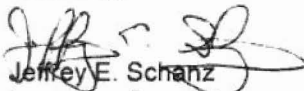
Thank you and your staff for conducting the peer review of the Legal Services Corporation, Office of Inspector General's audit program. We appreciate the team's comments and the professional and thoughtful manner in which they conducted themselves during the review.

I am pleased that your review resulted in the issuance of an unmodified opinion, indicating that the LSC OIG's quality control system was designed adequately and was functioning as prescribed and thus yielded reasonable assurance that Generally Accepted Government Auditing Standards (GAGAS) were being met.

We are also mindful that any organization's policies, procedures, and practices can be improved, and appreciate your identifying areas for improvement in our operations. As you will see from our detailed responses (attached), we are committed to implementing each of the recommendations in your report, and have included estimated completion dates for each of the anticipated actions.

I appreciate the opportunity to comment on the draft peer review report and look forward to receiving the final report. Again, I thank you and your team for your efforts and courtesies in conducting this peer review.

Sincerely,


Jeffrey E. Schanz
Inspector General

Attachment

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ATTACHMENT

Findings and Recommendations

Finding 1 – Minor deviations from fieldwork and reporting standards

Recommendation 1

We recommend that LSC IG take action to reinforce with the audit staff the need to meet all GAGAS requirements and provide training to all staff on the standards.

LSC OIG Response

While the finding indicated these were minor deviations, we are committed to improving our operations and will take prompt action to implement the recommendation. Since I arrived in March 2008, several important policies and practices were promulgated addressing some of the issues identified by the peer review. In one of my first actions, physical security controls were put in place over the file room and procedures were established to sign out files that were removed from the file room. These procedures will help ensure the security of the files and are now included in the OIG Administrative Manual published December 30, 2008.

As we modify and upgrade our policies to incorporate the July 2007 Yellow Book standards, we will include requirements for periodic training on all standards. While the minor deviations cited in the peer review did not impact the validity of the findings contained in the underlying reports, to ensure that all required items are adequately and properly addressed, a comprehensive checklist will be developed and completed for each audit assignment. The checklists will include the items identified in the above peer review finding as well as other applicable items. Both the auditor and the supervisor will sign-off on the checklist assuring that all required items are included in the audit file. In addition to being a quality control tool, the checklist will also be a training device that will remind all staff members to review their work, ensuring that audit objectives were met and that GAGAS were consistently applied.

We are also evaluating electronic work paper applications to standardize the audit product. (Estimated Completion Date: April 30, 2009)

Finding 2 – Need to strengthen internal quality controls

Recommendation 2

We recommend that, given its limited staff resources, the LSC IG establish an alternate quality control process that ensures audit documentation supports the audit having met GAGAS and modify its audit manual accordingly, consistent with GAGAS 3.51.

LSC OIG Response

The OIG agrees with the recommendation and appreciates the peer review team's recognition of the background and context in which the internal quality control program was established. When the policy on an internal quality control program was re-evaluated after the last peer review, the OIG anticipated it would be conducting a significant number of grant audits under GAGAS. This, we believed, warranted a more elaborate internal quality assurance program, including an annual review of the entire quality control system. However, because of other priority demands, including congressionally requested major reviews, the office did not conduct enough GAGAS projects to warrant the more elaborate program. (Independent referencing of audit reports was also an established part of our quality control program. All reports reviewed by the peer review team were independently referenced.) The rationale for the decision to not conduct the annual review was not documented. In the future, any significant deviations from policies will be documented and retained on file.

Consistent with the recommendation, the OIG will review current policy and establish an alternate quality control process, affording more flexibility and taking appropriate consideration of such factors as size, the degree of operating autonomy allowed to staff, the nature of our work, organizational structure, and appropriate cost-benefit considerations, and will modify our audit manual accordingly, in conformance with GAGAS 3.51. (Estimated Completion Date: April 30, 2009.)

Finding 3 – Gaps in audit policies and procedures

Recommendation 3

We recommend that the LSC IG direct that the OIG's existing audit policies and procedures be completely revised by a timely date. In completing this revision, the OIG should identify and use best practices of other OIGs and tailor them to meet its operating environment consistent with GAGAS.

LSC OIG Response

We agree with the recommendation and will take action to implement it promptly.

As noted in my response to Recommendation 1, a number of new policies and procedures, implemented following my arrival in March, address some of the issues identified by the review team. Specifically, with respect to auditors' understanding of independence requirements, I issued the *Legal Services Office of Inspector General Statement of Professional Standards*, effective August 7, 2008. The *Standards* document amplifies the Legal Services Corporation's Code of Ethics and Conduct and addresses all impairments to independence as contained in *Government Auditing Standards*. I have also appointed an ethics officer to provide advice and to review any ethics issues that arise pertaining to OIG staff members. In addition, I issued guidance that increases reporting requirements and formalizes supervisory approval for all OIG staff members who participate in paid outside employment.

The OIG has relied on the *Government Auditing Standards* for all areas not specifically covered in our policy manual, using it as a reference point to ensure that all standards were being met. However, to ensure that our policy manual is comprehensive, all areas identified by the review team will be specifically addressed. Moreover, consistent with the recommendation, the full audit manual will be reviewed and modified as necessary. (Estimated Completion Date: April 30, 2009.)