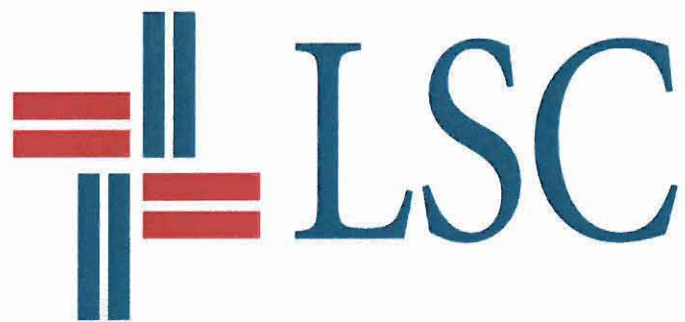


LEGAL SERVICES CORPORATION

Office of
Inspector General



Semiannual Report to the Congress
April 1, 2009 – September 30, 2009

www.oig.lsc.gov



November 23, 2009

The Honorable Tom Harkin, Chairman
Committee on Health, Education, Labor and Pensions
United States Senate
644 Dirksen Senate Office Building
Washington, D.C. 20510

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Dear Chairman Harkin:

The Office of Inspector General of the Legal Services Corporation (LSC) has completed its Semiannual Report for the period April 1, 2009 to September 30, 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 (Board) concurs with the presentation of statistics in Tables I, II and III 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 918 offices serving every Congressional district in the nation.

The Board continues to work toward the implementation and testing of all recommendations of the Government Accountability Office (GAO) regarding governance, oversight, and internal controls. In continuing these efforts, the Board has had the assistance of and complete cooperation from the Corporation's management. On October 27, in testimony before the Subcommittee on Commercial and Administrative Law of the House Committee on the Judiciary, Susan Ragland of the Government Accountability Office credited LSC with making good progress on all recommendations of the two GAO reports, saying in part,

The improvements that LSC has made in its governance and accountability provide a good foundation for completing implementation of the elements needed for a strong program of governance and internal controls.

As regards the new Office of Inspector General (OIG) audit reports issued during the reporting period, LSC has taken the following actions:

On the Audit of Selected Internal Controls at Legal Aid of NorthWest Texas (NWTexas), LSC has recently concluded a questioned cost proceeding with NW Texas, in which the program has agreed to use private funds to pay for the cost of natural stone used in the construction of its new building, amounting to approximately \$188,000. NWTexas has supplied the necessary supporting documentation regarding the expenditure of \$41,195 for a consultant contract that was also questioned in this proceeding and LSC informed the program in a letter dated September 16 that the costs are allowed. All documentation and follow-up instructions that LSC issued to the program regarding both of these matters have been forwarded to the OIG for a closeout of this recommendation.

Based on recommendations from the Audit of Legal Services Corporation's Consultant Contracts, LSC has made changes to its practices and to its Administrative Manual to ensure that contracting policy and procedures are consistent and that all contracts comply with the procedures. Training for staff involved in the contracting policy has been completed, and documentation of all changes in practice and procedures has been submitted to the OIG. Any additional documentation to close these recommendations will be promptly provided.

With regard to audits that have been open since the last reporting period, progress is as follows:

On the issue of classification of consultants as temporary employees, the matter is still under review by management and the Board with the assistance of outside counsel. While Management had anticipated the resolution of this issue by September 30, 2009, work on the issue is ongoing. The OIG will be kept fully and currently informed until final resolution.

On the issue of internal controls at Legal Aid and Defender Association (Detroit), the questioned costs issue was bifurcated, with one portion resolved and the information technology contract matter pending. A focused visit to the grantee was conducted on September 21 by the Office of Compliance and Enforcement and a determination letter has been sent to the program.

On the issue of internal controls at California Indian Legal Services (CILS), the grantee has stated that the costs of all unused hotel rooms have been moved to non-LSC funds. LSC has issued a final determination letter to the grantee covering all remaining questioned costs. CILS appealed our determination on October 30, and the President of LSC has 30 days to make a final ruling on the matter. The OIG will be promptly notified when the proceedings are concluded.

On the issue of internal controls at Legal Services New York City, all recommendations have been implemented and we are awaiting an update of the grantee's accounting manual to document proper distribution of indirect costs. A final manual is expected in December.

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.

We thank you and the Congress for the bipartisan support provided to LSC. Due to the ongoing justice gap in America, as recently documented in an updated and expanded version of our 2005 report, it is more important than ever to increase both private and public funding for civil legal assistance. Your support and leadership has been an important element in our success in building federal funding.

Equally important, of course, 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. We will keep Congress apprised of the progress made in strengthening internal financial controls and grants oversight.

If you have any questions or desire further information, please contact John Constance, Director, Government Relations and Public Affairs, at 202-295-1611.

Sincerely,

A handwritten signature in blue ink, appearing to read "F. Strickland", written in a cursive style.

Frank B. Strickland
Chairman

**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 April 1, 2009 through September 30, 2009.

We continued to focus significant audit efforts on reviewing the adequacy and effectiveness of internal controls at LSC-funded grantees. An audit of one grantee found questioned costs of over \$229,000 and identified concerns as to whether proper actions had been taken to protect LSC's interest in a building constructed predominantly with LSC's funds. Audits are underway at five other grantees.

We have also focused audit attention on key areas of the corporation's management and administration. This period we reported on LSC's use of consultant contracts, identifying a number of issues with respect to inadequate adherence to controls and to internal policies and procedures. We also reported on a significant issue of possible misclassification of contractors for tax purposes, with concomitant potential liability for fines, penalties, and other costs. We found this a matter of particular concern: despite a history going back over 15 years of questions or concerns being raised about this practice by LSC's legal office and the OIG (the matter was also identified as a reportable finding in the most recent corporate financial statement audit), LSC management continued the practice without taking effective action to resolve the issue. In their response to our report, management indicated that they now intend to change the questioned classification practice as of the close of the current reporting period.

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. During the period we issued two such audit service review (ASR) reports.

The OIG opened 18 new investigations, and closed 24 investigations this reporting period. A conviction was obtained in a case involving a grantee employee who had committed fraud against the program and its clients over a several year period.

As part of our emphasis on preventive efforts we launched a new Fraud Awareness Briefing Program for grantees, we continued to conduct on-site fraud vulnerability assessments, and we developed and distributed a guide on how to prevent computer laptop thefts. Our recent efforts to increase awareness of the OIG Hotline and to improve Hotline operations proved highly successful with significant increases in both the number and quality of Hotline calls as compared with previous periods.

I continue to be 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, to 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 "Jeffrey E. Schanz". The signature is stylized with a large initial "J" and "S".

Jeffrey E. Schanz
Inspector General
October 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 also identifies and reports 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, and 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 and contractors.

To ensure objectivity, the IG Act grants the LSC IG independent authority to determine what audits, investigations, and other reviews are performed, and empowers the IG to: gain access to all documents needed for OIG reviews; publish findings and recommendations based on OIG reviews; and 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 reports 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, when appropriate, 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 two significant audit reports and one peer review report. In addition the OIG initiated an audit of LSC's Technology Initiative Grant program and is continuing work on five grantee audits. The corporate audit firm for fiscal year 2009 was selected and the audit is in its early stages. Members of the audit staff provided substantial assistance in connection with an ongoing OIG investigation.

The OIG, in fulfilling its responsibility for overseeing the independent public accountant (IPA) audits performed at each grantee, reviewed 116 IPA reports received during the period and conducted two Audit Service Reviews (ASRs). ASRs are designed to ensure that the work conducted by the IPAs is in accordance with the instructions issued by this office and determine whether the work meets applicable professional standards. The OIG delayed implementing a requirement for IPAs to expand reporting on grantee internal control systems. The delay was necessary for the OIG to develop additional guidance for grantees and to allow time for grantees to implement the guidance before the IPAs conducted audits to satisfy the expanded reporting requirement. The requirement also may be affected by legislation pending before Congress that would modify the current auditing requirements. (The OIG provided extensive comments on this legislation.)

Audit of Selected Internal Controls at Legal Aid of NorthWest Texas

The OIG assessed the adequacy of selected internal controls in place at Legal Aid of NorthWest Texas (LANWT) related to certain of its operations and oversight activities and reviewed specific issues relating to the construction of the grantee's new building and a consulting contract entered into by the grantee's board of directors. The OIG found that the LANWT incurred costs of over \$188,000 to pay for decorative stone imported from Italy that was used in the construction of its new headquarters building. The OIG questioned whether the stone was a reasonable and necessary expenditure of LSC funds. The OIG also found that three payments to a consultant totaling over \$41,000, using LSC funds, were not fully supported. In addition, the OIG found that: the grantee had not taken the necessary actions to establish LSC's reversionary interest in its newly constructed building; the accounting manual did not address all required items and needed to be updated; required financial information provided to the grantee's board of directors did not contain sufficient explanatory material to help board members interpret the data received; and some written minutes of board meetings and audit committee meetings for 2008 were not available during our audit.

The OIG questioned costs totaling over \$229,000 and recommended that the grantee: (1) ensure that no LSC funds are used for the decorative stone; (2) establish LSC's interest in the new building; (3) update the accounting manual to include policies and procedures for internal reporting and budgeting as well as for contracting with consultants; and (4) adequately document board of directors meetings.

LANWT management disagreed with the findings and recommendations related to the imported Italian stone and the consulting contract, and disagreed with the associated questioned costs. LANWT management identified steps it was taking in response to the other issues in the OIG's audit report.

The OIG viewed most of LANWT management's comments as nonresponsive to the issues raised in the report. The unresolved issues, along with questioned costs of \$188,522 for the imported Italian stone and \$41,195 for inadequately supported contract expenditures, were forwarded to LSC management for action. The grantee is working with LSC to establish LSC's reversionary interest in the new building. The grantee has also completed the transcription of minutes for all meetings held in 2008.

Audit of Legal Services Corporation's Consultant Contracts

The OIG initiated an audit to determine whether LSC management had appropriate internal controls in place over consultant contracts, whether such controls were properly followed, and whether consultant contracting actions were in compliance with applicable laws, regulations, and LSC policies and procedures.

The OIG found that LSC may have entered into independent contractor agreements with individuals who should have been classified as employees under IRS rules. As a result, LSC could be liable for fines and penalties, as well as additional payments to workers.

The OIG also found that while controls over consultant contracts were in general adequately designed, key controls were not adhered to, and written policies and procedures over the consultant contracting process were not regularly followed, resulting in instances of noncompliance. The OIG reported that LSC needs to strengthen internal controls over consultant contract actions by documenting contracting decisions, evaluating contract alternatives, and establishing procedures to monitor contractor compliance with contract provisions.

On the issue of the possible misclassification of contractors for tax purposes, the report documented a history going back to 1992 in which questions and concerns were raised on multiple occasions by LSC's general counsel, by the OIG, and by independent auditors as to the need to address and properly resolve the issue.

Management was advised, at various times: (1) by its counsel – that counsel could not concur in LSC’s treatment of all its consultants as independent contractors; that it should consult with the IRS regarding the proper tax treatment of these individuals; and that these consultants generally are more properly classified as temporary employees and should be treated as such by LSC for tax purposes; (2) by the OIG – that LSC needed to review its practices with respect to classification of independent contractors to ensure that they complied with the Internal Revenue Code; and (3) by its independent public accountants in the corporation’s FY 2008 financial statement audit report – that LSC has not taken appropriate steps to ensure it is in compliance with the law or can sufficiently support the position it has taken. Notably, one of the independent accountants’ recommendations was precisely the same as that made by LSC’s general counsel in 1993: to utilize the IRS procedure (via form SS-8) specifically designed for the purpose of obtaining an IRS determination on this issue, “to ensure that LSC is fully compliant with this area of the Internal Revenue Code.”

Notwithstanding this history, the OIG’s July 2009 report noted that LSC continued to make decisions to classify workers as independent contractors rather than employees without appropriately documenting the rationale for its decision. This is not an inconsequential matter: the report noted that in a recent two-year period LSC entered into some 200 independent contractor agreements, the type that may have been improperly classified under IRS rules.

The OIG recommended that LSC management expeditiously resolve the issue of the status of LSC consultants as independent contractors versus temporary employees or seek an administrative determination from the IRS of the proper classification treatment.

The OIG also made a variety of recommendations to strengthen controls and ensure compliance with LSC policies and procedures. Specifically, the OIG recommended that LSC clearly document contract decisions in contract files; implement policies and procedures that require an annual acquisition plan; develop procedures to ensure that LSC contractors are not receiving compensation from an LSC-funded source when providing consulting services; provide a clear description of what should be documented in a justification for not awarding consultant contracts competitively; require that all proposed consultant contracts be approved by the general counsel and the comptroller’s office; evaluate and consider adding to the list of required information for all contracts items such as an integration clause and information on representations and warranties; require that the Contract Approval Form be used for all proposed consultant contracts; require that a review process be implemented that ensures contracts are properly executed before purchase orders are issued; specify the consultant contract-related records that need to be maintained in contract files and identify the office(s) that should maintain these records; provide training on the policies and procedures after they have been revised; and require periodic

reporting to the LSC President of all consultant contracts executed along with the Comptroller's certification that procedural sufficiency has been attained.

LSC management comments indicated that action will be taken on all recommendations. Management also noted in its comments that the report did not question any costs.

The OIG considers 10 of the report's 13 recommendations open, pending receipt and evaluation of further information from management clarifying or substantiating their intended actions. While LSC management's comment that the report questioned no costs is accurate, the relevant cost issue is not what was spent in the past, but what must be spent in the future to correct any misclassifications.

Since the report was issued, LSC management determined that some individuals who were classified as independent contractors should have been classified as temporary employees and that it now intends to modify those classifications. LSC management is attempting to quantify the financial impact of misclassifying these individuals. Management stated it intends to have all modifications made as of the close of this reporting period.

Peer Review

Audit organizations performing audits in accordance with Government Auditing Standards must have an external peer review performed at least once every three years by independent reviewers. Within the federal Inspector General community, the Council of Inspectors General for Integrity and Efficiency facilitates this requirement by scheduling IG audit functions to receive and conduct peer reviews. During this reporting period, the OIG conducted a peer review of another IG's audit function and issued the final report. The OIG's recommendations were adopted by the reviewed organization, which also expressed appreciation for our work and noted the findings and recommendations would enable it to improve its audit quality control system.

FY 2009 Corporate Audit

During this reporting period the OIG competitively selected an independent public accounting firm to conduct LSC's Fiscal Year 2009 corporate audit. The accounting firm held its entrance conference on the audit with the chairman of the LSC Board's audit committee, LSC management, and OIG staff in September 2009. The OIG will be monitoring the progress of the audit and the work of the auditors throughout the course of the audit.

Audit Reports

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

Recommendations to LSC Grantees

Pending at beginning of reporting period.....17
Issued during reporting period.....6
Closed during reporting period.....3
Pending at end of reporting period.....20

Recommendations to LSC Management

Pending at beginning of reporting period1
Issued during reporting period.....13
Closed during reporting period.....3
Pending at end of reporting period.....11

Oversight of IPA Audits

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 (IPA). 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 grantees and oversees the IPA process. The OIG's oversight of the IPAs consists mainly of two activities: the OIG (1) conducts a desk review of all IPA reports issued to grantees, and (2) conducts reviews of selected IPAs' documentation supporting the conclusions expressed in their reports. Reviews of supporting documentation are usually conducted at the office of the IPA. The purpose of both reviews is to ensure that the IPAs' work is conducted in accordance with the instructions issued by this office and determine whether the work meets applicable professional standards. The OIG issued two such reviews this reporting period.

Follow-up Process

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. The desk reviews of IPA reports performed by the OIG serve to identify significant IPA findings requiring follow-up by LSC management. IPA audit reports are submitted to the OIG within 120 days of the close of the grantee's fiscal year end. The OIG reviews each report and refers appropriate findings and recommendations to LSC management for follow-up. LSC management ensures that grantees submit corrective action plans for all material findings, recommendations, and questioned costs identified by the IPAs and referred by the OIG to management.

After corrective action has been taken by the grantee, 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.

Review of Grantees' Annual Audit Reports: IPA Audit Findings

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.

During the reporting period, the OIG reviewed 116 IPA audits of grantees with fiscal year ends of December 31, 2008 through July 31, 2009. These audit reports contained 52 findings. The OIG determined that 13 findings were not significant and closed the findings. Of the remaining findings, 38 were referred to LSC management and one finding was assigned for review within the OIG. The tables below present information on the findings referred to management this period (grantees with fiscal years ending December 31, 2008 through March 31, 2009). The OIG also uses these reports to aid in planning for audits, investigations, and other reviews.

Summary of Findings Reported in Grantee Financial Statement Audits

Total Number of Findings Referred	38
Number of Findings with Corrective Action Accepted	
By LSC Management	6
Number of Findings Awaiting LSC Management Review	32

Types of Findings Referred to LSC Management for Follow-up

<u>Category</u>	<u>Number of Findings</u>
Missing documentation	15
Weaknesses in Financial Transactions and Reporting.....	11
Regulatory Compliance Issues.....	6
Policies and Procedures.....	3
Internal Control Related	3
TOTAL.....	38

INVESTIGATIONS

The OIG opened 18 investigations during this reporting period. These included 10 criminal investigations, four compliance matters, and four fraud vulnerability assessments. The criminal investigations included allegations of counterfeited checks, fraudulent claims, and thefts of cash and property from LSC programs. The compliance investigations included allegations of violations of LSC statutes and regulations involving matters such as retaliation and outside practice of law.

During the reporting period the OIG closed 24 investigations. These included 12 criminal investigations, six compliance matters, and six fraud vulnerability assessments. The OIG also issued five Inspector General subpoenas in connection with an ongoing investigation.

One conviction was obtained during the period, as described below.

Former Program Employee Convicted

On April 23, 2009, the subject of an OIG investigation was convicted of mail fraud on a plea of guilty to one count of a seventy-three count federal indictment. The indictment and conviction were based on the subject's fraudulent activities over a period of several years while employed as an administrative assistant at an LSC grantee. Overall, the employee stole more than \$20,000 from the program and from scores of its clients. Sentencing is scheduled for November 12, 2009. Under the terms of the plea agreement, in addition to fines and imprisonment (to be determined, subject to a cap, at the time of sentencing), the subject agreed to make full restitution to all victims identified in the government's disclosure. The OIG previously issued a fraud alert to all grantee Executive Directors to highlight the issues and potential vulnerabilities identified by this case.

Grantee Improperly Accepted Attorneys' Fees

A grantee improperly collected over \$2 million in attorneys' fees in violation of 45 C.F.R. Part 1642 which prohibits grantees from claiming or collecting and retaining attorneys' fees. The OIG conducted an investigation into the circumstances under which the grantee collected attorneys' fees and confirmed that the grantee requested attorneys' fees, which were awarded by the trial court. Before the fees were collected, however, the case was appealed, the grantee withdrew, and without the grantee's knowledge the former clients as part of the overall settlement negotiated \$2 million in attorneys' fees for the grantee. The grantee was ordered to divest the funds and agreed to not seek LSC funding for five years.

Proactive and Preventive Initiatives

Fraud Awareness Briefing Program

One of the fundamental responsibilities of the OIG is to reduce the opportunities for committing fraud. Anti-fraud professionals know that the best way to deal with fraud is to prevent it from happening in the first place. There are any number of ways to try to prevent fraud, including establishing and adhering to adequate internal controls and setting the right “tone at the top.”

Many individuals, however, do not deal with fraud prevention on a regular basis, and, while generally aware of fraud, they are not aware of the potential for fraud in their own organizations. At the OIG, we not only have expertise in detecting and investigating fraud involving LSC funds, but also have the experience to show that fraud affects LSC-funded programs more than people might imagine. Many people mistakenly think that if there is fraud at all, the fraud must be minimal. In fact, LSC-funded programs have been victimized by frauds involving many thousands of dollars.

In order to increase awareness of the potential for fraud in LSC programs and operations, this reporting period the OIG initiated a Fraud Awareness Briefing Program. Our first presentation was made on June 15, 2009 to a joint session of LSC grantees in Pennsylvania. We subsequently conducted fraud awareness briefings for legal services programs in Alabama, Rhode Island, Massachusetts, Michigan, and California.

LSC grantees are invited to request a Fraud Awareness Briefing for all of their staff at a time and place convenient to the grantee. The grantees are generally not chosen because of any particular concern about the program, and the grantees visited so far have been very responsive to the OIG.

The Fraud Awareness Briefing is a presentation by experienced OIG investigators accompanied by a brief video from the Association of Certified Fraud Examiners (ACFE). The presentation covers topics including who commits fraud, why people commit fraud, how fraud can be prevented, how fraud can be detected, and what to do if fraud is suspected. The ACFE video provides a real-life look into the impact fraud can have not only on the victim but also on the person who commits the crime. In order to bring the point “close to home,” the investigators describe the various types of fraud schemes that have been perpetrated against LSC grantees, in many cases by their own staff members. Fraud Awareness Briefings provide an opportunity for attendees to ask questions and make suggestions regarding ways to prevent fraud. The OIG’s Fraud Awareness Briefings have been uniformly well-received and will continue to be offered to any LSC grantee interested in participating in this initiative.

Fraud Vulnerability Assessments

During this reporting period the OIG completed two fraud vulnerability assessments (FVAs) initiated during the prior period and four new FVAs. The FVAs consist of a focused document review in areas identified as weak or prone to abuse; a review of grantee internal control policies versus practices; and most often also include a fraud awareness briefing to the grantee's executive director and chief financial officer. 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 all LSC funds are subject to review.

The six FVAs completed during this reporting period found no indicators of on-going fraud. During one FVA the OIG was advised that an attorney employed by the grantee stole approximately \$150 from a client. The attorney's employment was terminated and the grantee referred the matter to the local district attorney. The grantee advised that the matter was not reported earlier to the OIG because the amount was under the \$200 grant assurance threshold for reporting to the OIG.

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. By briefing grantee managers on indicators of and any potential vulnerability to fraud and embezzlement, the OIG hopes to assist them in detecting early warnings of such problems.

Identity Theft

LSC grantees are not immune from identity theft. During the reporting period two grantee programs reported thefts of funds as a result of identity theft. In one situation, an e-mail attachment was opened by a program employee, believing it was a genuine message from a well-known shipping company. The attachment contained a virus designed to capture confidential information, resulting in multiple fraudulent fund transfers from the program's bank account. The OIG advised the program that it was victimized by a nationwide scam that was being investigated by federal law enforcement. At a second program, a client who had already collected his share of a settlement used copies of stolen identity papers to fraudulently collect another client's share.

Preventing Laptop Computer Theft

In keeping with their responsibility to report thefts of \$200 or more to the OIG, LSC grantees often report the theft of laptop computers. During this six-month reporting period, OIG received reports from five programs about laptop theft. Laptop theft continues to be the most frequently reported type of incident by LSC grantees. Laptop theft and loss is a serious risk. In addition to the cost of replacement, laptops of legal service providers generally contain confidential client information and other sensitive personal or business information. The theft or loss of a laptop can also disrupt and adversely affect work production.

To help address the continuing problem of laptop theft, the OIG developed “An OIG Guide for LSC-Funded Programs: How to Prevent Computer Laptop Theft or Loss.” The Guide was sent to all programs (and re-sent to those reporting thefts), informing them about simple steps that can be taken to prevent laptop theft and sharing best practices, such as storing all data on servers, not laptops, and using the laptops as “dummy” terminals. The Guide is another example of recent proactive OIG efforts to help programs prevent fraud and loss.

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 72 Hotline contacts (compared to 46 the previous reporting period). Of these matters, 13 were referred to LSC’s Office of Compliance and Enforcement for follow-up; eight were opened as investigations; one is open pending further inquiry; and the remaining matters were closed after review and, where possible, response to the Hotline complainant.

Over the past year we have worked both to improve Hotline operations and to increase awareness of the Hotline throughout LSC and the grantee community. We can report that quantitatively overall OIG Hotline activity increased by over 56% over the last period (which itself represented an increase of 70% over the preceding period). Hotline contacts for the current period when compared to the same time frame one year ago represent an increase of 167% (72 vs. 27). More importantly, 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.....24
Opened during reporting period.....18
Closed during reporting period.....24
Open at end of reporting period.....18

PROSECUTORIAL ACTIVITIES

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

INVESTIGATIVE ACTIVITIES

Inspector General subpoenas issued.....5

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 legislative, regulatory, and policy matters. The more significant items are discussed below.

The OIG provided comments to the Senate Committee on Health, Education, Labor, and Pensions concerning S. 718, the Civil Access to Justice Act of 2009, which is currently pending in the United States Senate. The comments recognized that the bill proposed useful reforms that would strengthen LSC and its grantees, but also expressed concern that a number of its provisions would undermine the OIG's effectiveness in key areas. Specific areas of concern included provisions that would weaken the OIG's oversight role in grantee audits; that would effectively deprive LSC funds of their Federal character for purposes of statutes governing the proper expenditure of Federal funds; and that would limit the OIG's access to grantee records. We noted the proposed changes were particularly troubling in light of recent GAO recommendations for improving and strengthening governance, oversight, and accountability at LSC and its grantees. We commented that in these respects, as well as others cited in the letter, S. 718 runs directly counter to the intent of Congress, as expressed in the recently-enacted Inspector General Reform Act of 2008, to enhance the authority of Federal Inspectors General to root out waste, fraud, and abuse in Federally-funded programs. As the period closed we began working with Congressional staff and participated in a number of briefings addressing these and other issues regarding the bill.

As previously reported, the OIG had issued an advisory memorandum informing the LSC Board that it appeared to be violating the Government in the Sunshine Act, as well as LSC regulations, by holding portions of its meetings concerning the LSC President's performance evaluation and contract renewal 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 of the close of the reporting period, LSC had changed its practice as to where it maintained the closed meeting transcripts, transferring them to the corporation's headquarters; however, the other issues remain unresolved.

The OIG also participated in the annual update of LSC's grant assurances, submitting comments and suggested revisions.

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 a request for information LSC grantees are required to provide under the terms of their grants. The OIG issued a subpoena seeking information relevant to the investigation.

In March 2007, the U.S. Department of Justice, on behalf of the OIG, 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. Although mediation proved unsuccessful, in April 2009 the LSC OIG submitted to the court additional briefing regarding a proposal to resolve all outstanding issues in the enforcement proceeding. As of this date, the subpoena enforcement action remains pending as the parties await the court's ruling on the OIG's proposal and all outstanding legal issues in the case. (We note that just after the close of this reporting period, on October 6, 2009, the district court ordered the parties to brief the question whether the case should be transferred to the Northern District of California pursuant to 28 U.S.C. §1404.)

Other Activities

During this reporting period, the OIG responded to four Freedom of Information Act requests. OIG counsel produced seven formal legal opinions during the period and provided training to OIG staff regarding statutory restrictions on grantee activities.

OTHER OIG ACTIVITIES

Congressional Requests

In response to a request from the Ranking Member, Senate Committee on Finance, the OIG provided a follow-up report on LSC travel outside the continental United States (OCONUS). The OIG reviewed the completeness and accuracy of LSC's responses to earlier Congressional requests; the completeness and accuracy of LSC's travel documentation records overall, including determining the level of compliance with established policies and whether expenditures were allowable and appropriate; the accuracy of travel expense reports; and any OCONUS travel sponsored by third parties.

The OIG reviewed all available documentation for a data sample of 65 trips covering the period 1998-2008. Our report noted that while LSC's submissions were generally responsive to the respective Congressional requests, each submission failed to include information about specific OCONUS trips by LSC staff or Board members. We reported that information on the relevant trips was available in LSC's travel files and that we could not find information explaining why it was not submitted as requested.

In reviewing both the relevant travel records from LSC's earlier submissions, as well as records from our review of travel for the period, the OIG found that the great majority of the internal travel expense reports reviewed were accurate. There were a few instances in which direct billing expenditures such as flights and lodging were not included on the expense reports, however recent improvements in LSC's accounting system and procedures led us to conclude that it was unlikely the omission of direct-billed expenditures would continue.

We identified one instance not previously reported to Congress where an OCONUS trip by an LSC officer was sponsored and paid for in part by a third party.

Finally, we noted that in recent years, LSC had progressively strengthened its policies through alignment with the federal travel guidelines as well as implementation of direct billing and tracking procedure improvements. The most recent records reviewed were accurate and largely complete, and reflected compliance with advance approval procedures. We reported that overall, LSC's policies and procedures for OCONUS travel appeared sound and without significant systemic problem.

(While not part of our report to the Ranking Member, we do note that effective October 1, 2009, LSC again revised its business travel policies to further

strengthen procedures to provide greater accounting clarification and improved controls in this area.)

Board of Directors Support

The OIG developed a new Board Reference Library containing a variety of information resources, primarily related to the background and functions of the OIG. Included are materials covering the history of the IG Act, the statutory authorities and responsibilities of the OIG, organizational structure, staffing, and planning materials, key OIG and GAO reports, information and guidance on nonprofit corporate governance, and links to LSC's statutes and regulations. The library is available online and will be maintained permanently as a training/orientation aid for new LSC Board members and as an ongoing reference resource for the Board.

Information Services Contracting

During the period, the OIG completed the process for competitively awarding an information technology services contract to upgrade aging IT systems and improve the OIG's ability to use grantee information in work planning and operations, thus improving overall interoperability.

Professional Assistance

The OIG provided assistance to the newly formed Council of the Inspectors General on Integrity and Efficiency (CIGIE) in its efforts to develop and refine planning, internal structure and processes, and administrative support functions for the organization. Additionally, the OIG responded to numerous CIGIE surveys.

GAO Support and Coordination

During the period, GAO initiated its third review of LSC operations in the last two years. The OIG has coordinated with and provided support and assistance to GAO in the conduct of each of its reviews.

TABLE I

AUDIT REPORTS ISSUED for the Period Ending September 30, 2009

<u>Report Title</u>	<u>Date Issued</u>	<u>Questioned Costs</u>	<u>Funds Put to Better Use</u>	<u>Unsupported Costs</u>
Audit of LSC's Consultant Contracts	07/07/09	\$0	\$0	\$0
Reports on Selected Internal Controls: Legal Aid of Northwest Texas	08/10/09	\$188,522	\$0	\$41,195

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

<u>Recipient</u>	<u>IPA</u>	<u>Date Issued</u>
Northwest Justice Project	Moss Adams, LLP	07/21/09
Central Virginia Legal Aid Society	Larry Saunders & Associates	09/24/09

TABLE II
Audit Reports Issued with Questioned Costs
for the Period Ending September 30, 2009

	NUMBER OF REPORTS	QUESTIONED COSTS	UNSUPPORTED COSTS
A. For which no management decision has been made by the commencement of the reporting period.	2	\$352,308 ¹	\$0
B. Reports issued during the reporting period	1	\$229,717 ²	\$0
Subtotals (A + B)	3	\$582,025	\$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	3	\$582,025	\$0
E. Reports for which no management decision had been made within six months of issuance	2	\$352,308 ¹	\$0

¹ 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.

² On August 12, 2009 the OIG referred to LSC management questioned costs in the amount of \$229,717 found in the audit, Report on Selected Internal Controls – Legal Aid of Northwest Texas. This issue of questioned costs remains open.

TABLE III

Audit Reports Issued with Funds to Be Put to Better Use for the Period Ending September 30, 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
F. Reports for which no management decision had been made within six months of issuance	0	\$0

TABLE IV

Audit Reports Issued Before This Reporting Period For Which No Management Decision Was Made By The End Of The Reporting Period

<u>Report Title</u>	<u>Date Issued</u>	<u>Questioned Costs</u>	
FY 2008 LSC Corporate Audit	01/28/09	\$0	Awaiting management's final actions to correct misclassifications of temporary employees as consultants.
Report on Selected Internal Controls Legal Aid and Defender Association, Inc.	02/05/09	\$273,054	Awaiting final decision on questioned costs.
Report on Selected Internal Controls California Indian Legal Services	03/27/09	\$79,254	Awaiting final decision on questioned costs.
Report on Selected Internal Controls Legal Services New York City	12/11/08	\$0	Grantee's request for extension to December 2009 approved to allow more time to develop adequate cost allocation system.

TABLE V

Index to Reporting Requirements of the Inspector General

IG ACT REFERENCE*	REPORTING REQUIREMENT	PAGE
Section 4(a)(2)	Review of legislation and regulations	15
Section 5(a)(1)	Significant problems, abuses, and deficiencies	3-6
Section 5(a)(2)	Recommendations with respect to significant problems, abuses, and deficiencies	3-6
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	None
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	19
Section 5(a)(7)	Summary of each particularly significant report	3-6
Section 5(a)(8)	Statistical table showing number of audit reports and dollar value of questioned costs	20
Section 5(a)(9)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use	21
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	22
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.



**OFFICE OF INSPECTOR GENERAL
HOTLINE**

IF YOU SUSPECT

FRAUD INVOLVING LSC GRANTS OR OTHER FUNDS
WASTE OF MONEY OR RESOURCES
ABUSE BY LSC EMPLOYEES OR GRANTEEES
VIOLATIONS OF LAWS OR LSC REGULATIONS

PLEASE CALL OR WRITE TO US AT

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REPORTS MAY BE MADE ANONYMOUSLY**