

# LEGAL SERVICES CORPORATION



## Office of Inspector General

Semiannual Report to the Congress  
April 1, 2017 – September 30, 2017

**LSC** | America's Partner  
for Equal Justice

LEGAL SERVICES CORPORATION

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**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, 2017 through September 30, 2017.

During this reporting period we issued five audit reports. Our audit reports focused on the adequacy of LSC grantees' internal controls, particularly with respect to financial operations. The reports documented specific control weaknesses and areas of concern and made recommendations for corrective action. Notably, the grantees agreed or partly agreed with 100% of our recommendations.

We continued a program of conducting vulnerability assessments of grantees' computer systems, testing for both internal and external weaknesses in their networks. We believe this can be of significant benefit to grantees, helping to identify and correct issues that could compromise the integrity of their information systems.

We also continued our Quality Control Review (QCR) program, to provide enhanced oversight of the independent audits required annually of LSC grantees. During the period we issued 11 QCRs.

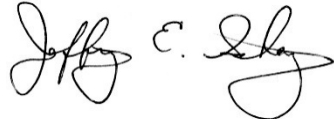
In addition to following up with the individual audit firms and grantees after each QCR, we provide an advisory memorandum for all of the independent auditors and executive directors, summarizing the results of the reviews conducted over the preceding fiscal year and identifying the principal exceptions and deficiencies found. These reports and the overall QCR process identify any systemic issues and help prevent the repetition of similar problems in future audits.

We opened 13 new investigations and closed 30 investigations during the reporting period. The investigations involved a variety of criminal and regulatory matters, including fraud, false claims, theft of client funds, and the misuse of LSC funds. Criminal charges were filed in two cases arising from our investigations, and a conviction obtained against a former executive director of an LSC subgrantee for theft of program funds. We made five new referrals to federal and local authorities for criminal prosecution. Our investigations also led to over \$80,600 in restitution and recoveries.

We continued to emphasize outreach and education as part of our ongoing efforts to help prevent fraud and abuse in LSC-funded programs, and maintained an active calendar of grantee outreach visits.

I wish to express my appreciation to all the members of the Board of Directors for the interest and support they have shown for the work of the OIG. I also remain deeply appreciative to the Congress for its steadfast support of this office.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey E. Schanz". The signature is fluid and cursive, with the first name "Jeffrey" being the most prominent part.

Jeffrey E. Schanz  
Inspector General  
October 31, 2017

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## OFFICE OF INSPECTOR GENERAL OVERVIEW

The LSC Office of Inspector General operates under the Inspector General Act of 1978, as amended, 5 U.S.C. App. 3. The OIG has two principal missions: (1) to promote economy and efficiency in the activities and operations of LSC and its grantees; and (2) to prevent and detect fraud and abuse.

Our primary tool for achieving these missions is objective and independent fact-finding. We perform financial and other types of audits, evaluations, and reviews, and conduct criminal and regulatory compliance investigations. Our fact-finding activities enable us to develop recommendations for LSC and its grantees, as well as for Congress, for actions that will correct problems, better safeguard the integrity of funds, and 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, 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 provided by the OIG. Congress has also specified that the OIG has authority to conduct its own reviews of grantees.

LSC's 2017 appropriation (exclusive of OIG operations) was \$380 million. The Corporation provides funding to 133 independent nonprofit legal aid programs throughout the U.S. and its territories.

The OIG is headed by an Inspector General (IG), who reports to and is under the general supervision of the LSC Board of Directors. The IG has broad authority to manage the organization, including setting OIG priorities, directing OIG activities, and hiring 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, to gain access to all necessary documents and information, and to report OIG findings and recommendations to LSC management, its Board of Directors, and directly 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 finds that there are reasonable grounds to believe that a crime has occurred. The IG is required by law to keep Congress informed of the activities of the office 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.

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 and effectiveness of legal services for low-income persons.

# AUDITS

As discussed below, during this reporting period the OIG issued five reports with respect to grantee operations and internal controls. At the conclusion of the period, we had three projects underway, in various stages of completion.

The OIG has responsibility for overseeing the independent public accountant (IPA) audits performed annually at each grantee. During the reporting period, we reviewed 122 IPA reports, with fiscal year ending dates ranging from December 31, 2016, through January 31, 2017.

We issued 11 Quality Control Review (QCR) reports this period. The goal of the QCR initiative is to improve the overall quality of the IPA audits and to ensure that all audits are conducted in accordance with applicable standards and with the guidance provided by the OIG.

## **North Mississippi Rural Legal Services, Inc.**

The OIG assessed the adequacy of selected internal controls at North Mississippi Rural Legal Services, Inc. (NMRLS). We found that while many of NMRLS's controls were adequately designed and properly implemented, some controls related to contracting needed to be strengthened and others needed to be formalized in writing.

We reported that the following areas needed to be improved:

- NMRLS's contracting policies and procedures did not include provisions on sole source procurement, maintenance and filing of documentation, the number of competitive bids required, and the types of contracts.
- NMRLS's policies relating to derivative income did not detail the different types of derivative income.
- NMRLS's cost allocation policies were not consistent with their current practice for allocating indirect costs.
- NMRLS's policies relating to internal reporting and budgeting were too general and were missing detailed elements, including budget formulation procedures, the timing of the budget process, budgeting responsibilities, and the budget approval process.
- Of the 14 contracts tested, five contracts did not have the required sole source justifications.

The OIG made three recommendations:

- The first related to establishing or updating written policies regarding cost allocation, derivative income, contracting, and the budgeting process.
- The second addressed the need for staff to be trained on revisions and additions to the written policies, to ensure that all new policies are followed and used in practice.
- The third related to internal controls over contracting, addressing the need to ensure that a sole source justification is prepared for every contract awarded on a sole source basis, in accordance with the grantee's written policies and updated accounting manual.

NMRLS management fully agreed with our findings and accepted all three recommendations.

The OIG considered the proposed actions to address all three recommendations responsive. One recommendation is considered closed. Two recommendations will remain open until the grantee has provided the OIG an updated accounting manual, obtained the required board of directors' approval for the new policies and procedures, and trained its staff on any new and updated policies.

### **West Tennessee Legal Services, Inc.**

The OIG assessed the adequacy of internal controls at West Tennessee Legal Services Inc. (WTLS). We found that while many of the controls were adequately designed and properly implemented, some controls needed to be fully implemented and/or formalized in writing.

We reported that the following areas needed to be improved:

- WTLS had no written policies and procedures for management reporting and budgeting, and no written policies related to their line of credit accounts. Also, the written policies and procedures for cost allocations, disbursements, and for property and equipment related to grantee owned vehicles, needed to be enhanced to include practices in place so as to properly describe the controls followed by the grantee.
- WTLS did not maintain appropriate segregation of duties with respect to the maintenance of the master vendor list. The financial assistant responsible for accounts payable duties, including initiating and processing payments, was also responsible for the maintaining the master vendor list. Also, both the business



manager and the financial assistant could add new vendors and make changes to vendor information.

- WTLS had no documentation of prior approvals for out of state travel for seven out of nine disbursements totaling \$8,792.18.
- WTLS lacked adequate documentation of its contracting activities. Two contracts for service and maintenance had no documentation of approvals, and one service agreement was made with a former employee but was not documented in writing nor was a contract established.

The OIG made seven recommendations:

- Four recommendations related to enhancing and/or establishing written policies and procedures:
  - Enhance written policies and procedures related to the use of grantee owned vehicles to include current practices in place.
  - Document policies and procedures that describe how LSC-unallowable expenses are to be recorded.
  - Develop written policies and procedures describing the process governing the preparation, content, and use of management reports and budgets.
  - Develop written policies specific to line of credit accounts, including procedures to ensure that only a limited number of authorized individuals can purchase goods and services and that any personal and/or disallowed charges may be deducted from the employee's paycheck.
- Two recommendations related to disbursements:
  - Establish and adhere to written policies for securing and approving new vendors to ensure segregation of duties.
  - Ensure that staff abide by WTLS travel policies.
- One recommendation related to contracting:
  - Ensure that each contract action is fully documented and maintained in a central file.

The grantee agreed with all recommendations. Two recommendations were closed and five recommendations remain open pending written notification that the proposed actions have been completed and policies have been revised and implemented.

## **Utah Legal Services, Inc.**

The OIG assessed the adequacy of selected internal controls at Utah Legal Services, Inc. (ULS). We found that while many of ULS's controls were adequately designed and properly implemented, some controls needed to be strengthened and others needed to be formalized in writing.

We reported that the following areas needed to be improved:

- ULS's property records did not include all of the elements required by the Fundamental Criteria provisions of the LSC Accounting Guide.
- ULS recorded some assets as a group under a single line item on the property record, instead of individually recording them. There was no way to verify items shown on the property records because the records did not list the tag number, inventory control number, serial number/identification number, or location of each asset.
- ULS did not follow its own policies and procedures for tagging inventory. The OIG did not locate tags on any of the grantee's property.
- ULS's policies and procedures related to general ledger and financial controls did not specify that the reviewer of the bank statements was to document evidence of the review by signing and dating the bank reconciliations.
- ULS's policies related to derivative income did not include the written methodology on how interest income was to be allocated to the different funding sources.
- ULS's contracting policies lacked details on the procedures for procuring various types of contracts, the types and dollar value of contracts that require competition, and the requirement that all contract actions be maintained in a central file.
- ULS's policies related to internal reporting and budgeting did not address budget formulation procedures, the timing of the budget process, budgeting responsibilities, and the budget approval process.
- ULS did not maintain the bids and other procurement documentation for one contract, out of seven contracts tested.
- ULS had a technology consulting contract that had been held by the same consultant for an extended period without opening the contract for rebidding.
- The contracts, bids, quotes, proposals, sole source justifications, and other evaluation materials were not filed in a central location for any of the seven contracts tested.

The OIG made six recommendations:

- Three recommendations related to internal controls over fixed assets, addressing the need to strengthen practices by updating property records to meet the requirements of the Fundamental Criteria, ensuring that assets are individually recorded in the property records, and ensuring that the grantee follows its own policies and procedures for the tagging of inventory.
- One recommendation related to the need to establish or update written policies over the general ledger and financial controls, derivative income, contracting, and internal reporting and budgeting.
- Two recommendations related to internal controls over contracting, addressing the need to ensure that all documentation for each contract action is filed in a central location, and to consider rebidding a long outstanding contract to ensure the grantee is receiving the best price and service available.

ULS management fully agreed with all the findings and accepted all six recommendations.

The OIG considered the proposed actions to address all the recommendations as responsive. The actions taken and planned by the grantee management to revise and update its accounting manual are deemed adequate. The recommendation regarding establishing and updating written policies will remain open until appropriate action is taken and board of directors' approval is obtained. The remaining five recommendations are considered closed.

### **Legal Services of Southern Missouri**

The OIG assessed the adequacy of selected internal controls in place at Legal Services of Southern Missouri (LSSM). While some of the controls were adequately designed and properly implemented as they relate to specific grantee operations and oversight, we found that controls in the areas detailed below needed to be strengthened and/or formalized in writing.

We identified the following as areas that needed improvement:

- Although their written cost allocation policies adhered to the Fundamental Criteria, in practice, LSSM's cost allocations did not follow their policies, and were not always accurate.
- Of the 12 vendor files reviewed, we noted inadequate contracting documentation as follows:

- For two of the vendor files, management was unable to locate a documented contractual agreement.
  - One vendor contract did not have the contractual period included in the contract.
  - For two of the vendor files, LSSM management was unable to determine how the vendor was contracted; LSSM was unable to provide supporting documentation of the contracting process for three of the remaining vendors.
  - Four vendors had several invoices paid that did not agree with the price stated in the contract agreement.
- Both the director of finance and the office administrator had full access to the master vendor list, and could edit, delete, and add new vendors. The office administrator was also responsible for accounts payable duties, including initiating and processing payments.
  - Of the 128 individual disbursement transactions reviewed, 33 transactions totaling \$40,833 were missing appropriate approvals.
  - LSSM's written policies and procedures regarding credit cards and fixed assets policies did not fully adhere to LSC's Fundamental Criteria. LSSM's written policies and procedures for employee benefits needed to be updated to include all benefits offered to employees.
  - Ten travel related credit card charges by staff, including the executive director, amounting to \$6,195, lacked prior approval. There were also two Walmart and 10 Staples transactions for which purchase orders, required by the grantee's policy, were lacking.
  - Since the director of administration retired in January 2017, there had been no segregation of duties with respect to payroll and human resource administration. There was also a lack of segregation of duties regarding bank reconciliation and bookkeeping.
  - One individual's pay increase did not have documented executive director approval, required by the grantee's policy.
  - Although written policies and procedures for derivative income were adequate, they were not always followed in practice. Interest and rental income were not allocated in accordance with grantee policy and LSC requirements.

- Internal controls over fixed assets records and the electronic tracking listing were inadequate.
- Bank reconciliations performed in December 2016 and January 2017 identified seven checks, issued to vendors and individuals, outstanding for over six months.

The OIG made 16 recommendations:

- One recommendation related to cost allocation, addressing the need to ensure the practices used to allocate costs to funding sources are consistently applied and follow LSSM's documented written policies.
- One recommendation was to ensure that contracts for services are written, signed, and maintained for all business arrangements, that they fully document all terms, and that they are reviewed periodically to ensure they are current.
- Two recommendations related to internal controls over disbursements, addressing the need to ensure that there is appropriate segregation of duties, that requisite approvals are obtained before disbursements are made, and that there is board of directors oversight for the executive director's expenses.
- Three recommendations related to internal controls over credit cards: enhancing written policies and procedures; ensuring that purchase orders are used in accordance with LSSM's operations manual; and implementing a preapproval process for travel related credit card purchases.
- Two recommendations related to internal controls over payroll: ensuring that management reviews and approves payroll changes, especially in cases where full segregation of duties is impracticable; and ensuring that LSSM is following its policy regarding approval of pay increases.
- One recommendation was to ensure that all current benefits, such as the cell phone reimbursement offered to employees, are included in the grantee's written policies.
- One recommendation was to ensure that interest and rental income are allocated among funding sources in accordance with the respective grant conditions, LSC requirements, and the grantee's written policies.
- Two recommendations related to internal controls over fixed assets: ensuring that a complete physical inventory is conducted in all locations and fully reconciled with

the property records; and ensuring that all fields of the fixed assets records and electronic tracking listing are complete and accurate.

- Three recommendations related to internal controls with respect to the general ledger and financial controls: ensuring that staff responsible for bank reconciliations have no bookkeeping duties; that the responsible individual reviews and approves journal entries to ensure they are complete, accurate, and properly supported prior to posting in the general ledger; and that management follows up on checks outstanding for more than six months to void or re-issue them, as required by the grantee's policy.

The grantee agreed with all the findings in the report and accepted all 16 recommendations.

The OIG considered the actions proposed by the grantee to address all the recommendations as responsive. The actions planned by grantee management to address the issues and revise and update its accounting manual should correct the issues identified in the report. Eleven recommendations remain open pending written notification that the proposed actions have been completed and policies have been revised and implemented. Five recommendations are considered closed.

### **Legal Aid Society of Northeastern New York, Inc.**

The OIG assessed the adequacy of selected internal controls at the Legal Aid Society of Northeastern New York, Inc. (LASNNY). We found that while many of LASNNY's controls were adequately designed and properly implemented, some controls related to contracting needed to be strengthened and others needed to be formalized in writing.

We reported that the following areas needed to be improved:

- LASNNY's property records did not include several of the elements required by the Fundamental Criteria, including, the tag number, inventory control number, serial number/identification number, and location of each asset.
- LASNNY records assets as a group under one line item on the property records, instead of individually. There was no sure way to identify the actual items or verify the accuracy of the records.
- LASNNY had not begun to fully utilize the recently implemented tagging system to track individual items.

- LASNNY's policies and procedures related to general ledger and financial controls did not include a specific timeframe in which outstanding checks will be investigated and resolved.
- LASNNY's policies related to derivative income did not include the written methodology on how certain forms of derivative income, including interest and rental income, are to be allocated.
- LASNNY's contracting policies failed to specify that documents related to each contract action are to be retained and kept in a central location with the contract files; did not include procedures for procuring contracts at different threshold amounts; and did not address when the board of directors should be notified of or give approval to contracts.
- LASNNY's internal reporting and budgeting policies did not address budget formulation procedures, the timing of the budget process, budgeting responsibilities, and the budget approval process.
- LASNNY's credit card policies did not address the activation and deactivation of a cardholder's account.
- LASNNY's policies related to fixed assets lacked a provision for the inventory and disposal of non-capitalized items that may contain sensitive information (e.g., laptop computers).
- Of the nine contracts tested, none had supporting documentation (bids, quotes, selection criteria, and sole source justifications) centrally filed with the contract.
- Three of the nine lacked information stating the terms of the contract, such as start and/or end dates.
- Two of the nine lacked signatures showing grantee approval.
- LASNNY had outstanding checks greater than 60 days that had not been investigated and resolved.
- Of the 217 disbursement transactions sampled, five transactions totaling \$1,353.50 did not receive requisite approval.
- There was a lack of segregation of duties as to both the fiscal director's and staff accountant's access to the master vendor list.

- Of the 130 credit card transactions sampled, 25 transactions totaling \$3,170.75 were missing receipts or other support.
- LASNNY did not require employees to sign a user agreement acknowledging receipt of a credit card and that they would abide by the terms of usage.

The OIG made 10 recommendations:

- One recommendation related to internal controls over fixed assets, addressing the need to strengthen practices by updating property records to meet the requirements of the Fundamental Criteria, ensuring that assets are individually recorded in the property records, and ensuring that the grantee fully utilizes the new inventory tagging system.
- One recommendation addressed the need to establish or update written policies over the general ledger and financial controls, derivative income, contracting, internal reporting and budgeting, credit cards, and fixed assets.
- Three recommendations related to internal controls over contracting, addressing the need to ensure that all documentation for each contract action is filed in a central location, that all relevant contract terms are stipulated in the contract before it is executed, and that signatures are documented on the contract showing that it was approved by the grantee.
- One recommendation related to internal controls over the general ledger and financial controls, addressing the need to ensure that grantee personnel adhere to the policy on investigating outstanding checks.
- Two recommendations related to internal controls over disbursements, addressing the need to ensure that appropriate approvals are made on all disbursements, and that the grantee segregates the duties of maintaining the master vendor file and of making payments.
- Two recommendations related to internal controls over credit cards, addressing the need to ensure that cardholders follow the stated policy regarding turning in hard copy or online receipts for all transactions, and that the grantee obtain written agreement from each current credit cardholder acknowledging that person's responsibility to use the card only for business purposes, that no misuse will occur, and that the cardholder will be held accountable for any personal charges made on the card.

The OIG considered the proposed actions to address all the recommendations as responsive. The actions taken and planned by grantee management to revise and update its accounting manual should correct the issues identified in the report. Two recommendations will remain open until the grantee has updated its accounting manual



and obtained the required board of directors' approval or fully implemented their planned actions related to the findings. The remaining eight recommendations are considered closed.

### **Vulnerability Assessment of Grantee Computer Networks**

We continued a program, begun in 2016, of conducting vulnerability assessments of grantees' computer networks. Working through a specialized contractor, assessments were performed on three grantees' systems. The tests scanned for potential vulnerabilities in the architecture, technologies, and system processes, from both outside and within the grantees' networks.

The assessments found that the grantee sites tested generally did not present a high level of risk of exposure from outside their networks. No critical or high-level vulnerabilities were found in the external boundary of any network space. Some critical vulnerabilities were discovered at each grantee site that were internal to the network environments. These principally resulted from out-of-date operating systems and missing patches and updates. A complete list of potential issues and vulnerabilities was provided to the grantees for review and remediation. A list of corrective actions and best practices was also provided to the grantees.

## **Statistical Summary**

### **Audits**

Open at beginning of reporting period .....	5
Opened during the period .....	5
Audit reports issued or closed during reporting period .....	5
Open at end of reporting period .....	5

### **Recommendations to LSC Grantees**

Pending at beginning of reporting period .....	104
Issued during reporting period .....	42
Closed during reporting period .....	60
Pending at end of reporting period .....	86

### **Recommendations to LSC Management**

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

## **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 (including the Compliance Supplement), which incorporates most requirements of 2 CFR 200, Uniform Guidance (Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards).

The OIG provides guidance to the IPAs and grantees, as well as general oversight of the IPA process. Our oversight activities, detailed below, include desk reviews and a quality control program, which includes independent onsite reviews.

### **Desk Reviews of IPA Reports**

The OIG conducts desk reviews of all IPA reports issued to grantees. This process enables us to identify and forward significant IPA findings to LSC management as necessary. We also track recommendations to determine whether appropriate responsive actions have been taken. We use information from the review of the IPA reports as part of our risk assessment and planning processes, identifying potential problems or concerns that may warrant follow-up via audit, investigation, or other review.

### **Quality Control Reviews**

We began the seventh year of our Quality Control Review (QCR) initiative. Under this program, IPA firms performing grantee audits are subject to review to determine whether their work is being conducted in accordance with applicable standards and with the instructions issued by our office. The reviews are conducted by a CPA firm under contract to the OIG. The contractor also identifies issues that may require further attention or additional audit work by the IPA under review.

During this reporting period, we conducted 11 QCRs. Two of the QCRs conducted were of FY2015 audited financial statements; nine were for FY2016.

Three of the QCRs met standards with no deficiencies. Seven met standards with one or more exceptions. Of the seven meeting standards with exceptions, three required the IPA to perform additional work and provide documentation to support their conclusions. For four of the QCRs that met standards with exceptions, the OIG issued recommendations to the IPA to implement in future audits of the grantees.

One QCR conducted during the reporting period found that a grantee's financial statement audit did not meet standards. The OIG issued a notice to the IPA requiring them to perform corrective action and provide additional information to address the deficiencies. The additional work performed by the IPA is currently under review by the OIG.

During the previous reporting period, we found 12 FY2015 QCRs met standards with exceptions and required the IPAs to perform additional work and provide additional documentation to support their conclusions. We evaluated and accepted the additional work and documentation submitted by six IPAs in that reporting period. This reporting period we evaluated the documentation and additional work submitted by the other six IPAs and determined that the deficiencies had been corrected by the IPAs for four QCRs. For the remaining two QCRs, our evaluation is ongoing.

### **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. IPA audit reports are submitted to the OIG within 120 days of the close of each grantee's fiscal year. As noted above, through our desk review process the OIG reviews each report and refers appropriate findings and recommendations to LSC management for follow-up. LSC management is responsible for ensuring that grantees submit appropriate 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 a grantee, LSC management notifies the OIG and requests that the finding(s) be closed. The OIG reviews management's request and decides independently whether it will agree to close the finding(s).

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

In order to provide more complete information in our semiannual reports to Congress, the OIG customarily includes 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 reflect the work of the IPAs, not the OIG.

During this reporting period, the OIG reviewed a total of 122 IPA audits of grantees with fiscal year ending dates from December 31, 2016 through January 30, 2017. Of the 122 audits, seven are sub-recipients of LSC funds. These audit reports contained 69 findings. The OIG reviewed the findings and determined that 40 were either not significant, or that corrective action had already been completed. The remaining 29 findings were referred to LSC management during the period for follow-up. The following tables present information on those findings.

**Summary of Findings Reported in Grantee Financial Statement Audits with Fiscal Years Ending December 31, 2016 through January 30, 2017**

Total Number of Findings Referred .....	29
Number of Findings with Corrective Action Accepted by LSC Management .....	0
Number of Findings Awaiting LSC Management Review .....	29

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

<b><u>Category</u></b>	<b><u>Number of Findings</u></b>
Financial Transactions and Reporting .....	10
Policies and Procedures/Other .....	7
Missing Documentation .....	7
Timekeeping .....	5
TOTAL .....	29

## **INVESTIGATIONS**

During this period, OIG investigations resulted in criminal charges being filed in two cases; the entry of a guilty plea and subsequent sentencing action; and two regulatory referrals to LSC management. LSC management also made five decisions, totaling nearly \$45,500, to recover funds based on our questioned cost referrals for unreasonable and/or unauthorized expenditures by grantees.

The OIG opened 13 cases during the period. These included eight investigative cases, two Regulatory Vulnerability Assessments, and three Fraud Vulnerability Assessments. The investigative cases included allegations of fraudulent travel claims, theft of client funds, time and attendance fraud, misappropriation of LSC funds, and potential violations of LSC statutes and regulations.

The OIG closed 30 cases during the reporting period. These included 17 investigative cases, five Regulatory Vulnerability Assessments, and eight Fraud Vulnerability Assessments.

### **Criminal Proceedings**

#### **Conviction and Sentencing of Former Executive Director**

A former executive director of an LSC subgrantee was convicted on a guilty plea to a criminal information charging her with theft from a program receiving federal funds. She was sentenced in federal court to five years' probation, five months home confinement, and a fine of \$10,000.

An OIG investigation found that the former executive director had defrauded the program of over \$35,000 by writing program checks to herself; using the program credit card for personal purposes; purchasing art items which could not be accounted for; and making duplicate reimbursements to herself. In addition to the sentence imposed, pursuant to the plea agreement the former executive director returned missing property and paid full restitution to the program in the amount of \$35,116.

#### **Indictment and Termination of Employment of Managing Attorney**

An OIG investigation was initiated based on an executive director's report to the OIG of possible theft by a grantee employee. The investigation found that a managing attorney was receiving attorneys' fees from court appointed cases. The attorney was working these cases as a grantee employee and had entered the cases into the grantee case management system. LSC regulations required the managing attorney to remit attorneys' fees from court appointed cases to the grantee. The investigation determined that the

employee had misappropriated approximately \$25,000 in attorneys' fees for personal benefit.

Subsequent to the initiation of the OIG's investigation, the executive director terminated the employee.

As a result of the OIG investigation, the managing attorney was indicted for theft from a program receiving federal funds.

## **Recovery Actions**

### **Five Investigations Result in Recovery of Unallowable Expenses**

1. As described in our previous Semiannual Report to Congress, an OIG investigation identified potential unallowable expenses incurred by a grantee for meal and gift purchases by grantee employees using their program credit cards. We found that from 2011 through 2015, grantee employees spent over \$58,000 on local lunches for executive and senior employees, staff holiday gifts, and other potentially unallowable purchases. The investigative findings were referred to LSC management.

This period, LSC management made a final determination to disallow \$22,247. The finding was, in part, based on the portion of the total expenditures attributable to LSC funds. The grantee determined that it would not contest the matter and it would repay LSC the \$22,247.

Additionally, in response to the OIG investigation, the grantee adopted new internal control policies related to credit card use and revised its accounting and personnel manuals to ensure consistency with LSC regulations.

2. As described in our previous Semiannual Report to Congress, an OIG investigation identified potentially unreasonable and unnecessary purchases made by a grantee for an office party, flower arrangements, musical entertainment, and cake orders. The purchases were made as part of efforts to recruit pro bono attorneys, in connection with LSC's private attorney involvement mandate.

The OIG referred \$17,896 as potential questioned costs to LSC management. LSC management agreed with the OIG's referral and negotiated with the grantee for recovery of the full amount of the referral.

3. An OIG investigation, reported in our previous Semiannual Report, identified potential unreasonable bar fees and travel reimbursements incurred by a grantee. The travel reimbursements were for mileage between an employee's assigned

office and his personal residence. The OIG referred \$4,014 in potential unallowable costs to LSC management.

This period, LSC management made a final determination to allow the bar fees portion of the questioned cost referral and disallow \$2,924, the amount of the travel expense reimbursements. LSC management received a check from the grantee for the full disallowed amount.

4. An OIG investigation of an LSC grantee's executive compensation practices identified potential unallowable compensation paid with LSC grant funds. The investigation was predicated on a proactive OIG fraud prevention and detection project, which reviewed salary and other forms of compensation earned by LSC grantees' key employees.

Following the OIG's referral of the matter, LSC management determined that in 2013, a grantee's chief operating officer received a bonus that was not paid in compliance with established procedures. LSC issued a management decision directing the grantee to repay \$1,964, the amount of LSC funds used to pay the bonus. In addition, the decision recommended that the grantee's board of directors adopt a formal performance bonus policy.

5. An OIG investigation identified potential unallowable expenses incurred by a grantee in reimbursing an employee for travel from his home to the grantee office. The grantee permitted the attorney to work from his residence, which was located out of state. A review of grantee travel documents found that the employee was reimbursed \$459 for travel from his residence to the grantee office for a routine office meeting. The grantee's travel policy prohibited travel between an employee's residence and his or her office from being considered official travel.

The OIG referred \$459 in potential questioned costs to LSC management. Prior to a decision on the referral, the grantee provided LSC a check for \$459.

## **Regulatory Investigations**

### **Fee Generating Cases**

The OIG received a Hotline complaint alleging that a grantee collected excessive contingency fees from clients in violation of 45 C.F.R. 1609, Fee Generating Cases. An OIG investigation determined that the grantee was receiving attorneys' fees from the client's portion of an out of court settlement.

The OIG referred the issue to LSC management to determine whether the grantee's practice of deducting their portion of attorneys' fees from the amount of the client's lump



sum settlement posed potential ethical and/or conflict of interest issues between the grantee and its clients.

LSC management is reviewing the matter to determine what advice can be provided to the grantee on this issue.

### **Lobbying Activities and Program Integrity**

Based on a Hotline complaint, an OIG investigation was initiated into possible regulatory violations by an LSC grantee. The investigation determined that grantee employees, including three who were serving on the board of directors of a non-profit entity, may have engaged in lobbying activities. In addition, the non-profit entity contracted with a registered lobbyist, who shared office space with the LSC grantee.

We identified potential violations of 45 C.F.R. Part 1610, Use of Non-LSC Funds, Transfers of LSC Funds, Program Integrity, and 45 C.F.R. 1612, Restrictions on Lobbying and Certain Other Activities. We referred our findings to LSC management for review.

### **Fraud Prevention Initiatives**

The OIG maintains an active fraud prevention program, engaging in a variety of outreach and educational efforts intended to help protect LSC and its grantees from fraud and abuse. We regularly conduct Fraud Awareness Briefings (FABs), Fraud Vulnerability Assessments (FVAs), and Regulatory Vulnerability Assessments (RVAs). We provide fraud alerts and other information to help increase grantees' awareness of developing trends that may pose a risk to LSC funds.

### **Fraud Awareness Briefings**

FABs are presented by experienced OIG investigative staff and cover topics such as who commits fraud, what conditions create an environment conducive to fraud, how fraud can be prevented or detected, and what to do if fraud is suspected.

While employees at LSC-funded programs may generally be aware that fraud and abuse can occur at any organization, they may not be aware of the potential for such incidents to occur within their own programs. FABs highlight the unfortunate truth that a number of LSC-funded programs have been victimized by frauds involving hundreds of thousands of dollars, and in one case the diversion of over a million dollars in grant funds.

The FABs describe common types of fraud, with particular focus on the various schemes that have been perpetrated against LSC grantees and the conditions that helped facilitate the losses. The briefings aim to foster a dialogue with staff and to engender suggestions for ways to help protect their own programs from fraud and abuse.

Since initiating the FAB program in 2009, we have conducted 151 briefings for grantees and subgrantees in all 50 states, the District of Columbia, and five territories, as well as briefings for the LSC Board of Directors, LSC headquarters personnel, a presentation at a National Legal Aid and Defender Association annual conference, and five webinars that reached multiple grantees.

Two FABs were completed at subgrantees and one FAB webinar was provided to new LSC grantee executive directors and other employees at six programs during this reporting period.

### **Fraud Vulnerability Assessments**

FVAs are conducted at LSC grantee offices and include a focused document review in areas considered high risk or prone to abuse. We also review the grantee's internal control policies and the degree to which they are complied with in practice. Finally, we conduct a personal briefing for the executive director and principal financial officer on fraud detection and prevention measures appropriate to their particular program.

A typical FVA can include reviews of credit card transactions, petty cash, bank account reconciliations, travel claims, office supply expenses, and other selected areas that have been linked to the commission of fraud at grantee programs. FVAs can help grantees identify both existing vulnerabilities and potential problem areas. FVAs sometimes detect ongoing fraud or abuse which may result in further investigation. FVAs also serve as a deterrent by helping grantee staff members become aware of the potential for fraud and reminding them that the OIG will investigate and seek to prosecute cases involving fraud or misuse of LSC grant funds.

Eight FVAs were closed during the reporting period.

### **Regulatory Vulnerability Assessments**

We began conducting RVAs based our experience in investigating financial frauds in which grantees were victimized. We often found that noncompliance or laxity with respect to certain regulatory and other requirements contributed to an environment that increased the potential for fraud. RVAs, conducted at grantee offices, seek to determine whether the grantee is following applicable provisions of the LSC Act, LSC regulations, grant assurances, provisions of the Accounting Guide, and case documentation and reporting requirements as set forth in LSC's Case Service Report Handbook. We have found that by focusing our reviews on certain key areas, we are able to assist grantees in identifying regulatory compliance issues that could also lead to broader potential financial vulnerabilities.

Five RVAs were closed during the reporting period.

## **Fraud Alert on Computer Banners**

The OIG issued a fraud alert to executive directors and their boards of directors to inform grantees of the importance of incorporating warning banners into their computer systems, and of the need for written policies governing the use of grantee computers and networks. The alert explained the nature and use of such banners, and that they should explicitly caution users regarding the prohibitions and limitations attendant to the use of grantee equipment and systems, particularly the absence of any expectation of privacy, and that misuse may result in criminal or administrative sanctions.

## **Fraud Alert on Outside Employment**

The OIG issued a fraud alert to executive directors and their boards of directors to inform grantees of OIG investigations dealing with the risk of fraud, waste, and abuse associated with non-attorney outside employment.

The alert identified several trends relating to non-attorney staff failing to notify management of their outside employment, diverting potential income-eligible clients to their outside employment in order to collect illicit fees, and working their outside jobs during grantee business hours.

The alert offered suggestions for detecting potential outside employment abuse and best practices to prevent potential conflicts of interest, theft of program resources, or the improper diversion of clients.

## **Hotline**

The OIG maintains a Hotline for reporting illegal or improper activities involving LSC or its grantees. Information may be provided by telephone, fax, email, or regular mail. Upon request, a provider's identity will be kept confidential. Reports may also be made anonymously.

During this reporting period, the OIG received 42 Hotline contacts. Of these matters, five were referred to LSC management for follow-up, four were opened as investigations, and the remaining 33 were closed.

## Statistical Summary

### Investigative Cases

Open at the beginning of period .....	38
Opened during period.....	13
Closed during period .....	30
Open at the end of period .....	21
Investigative reports issued.....	8

### Prosecutorial Activities

Referrals pending at the beginning of the period .....	0
Persons referred to DOJ for criminal prosecution .....	3
Persons referred to state and local prosecuting authorities for criminal prosecution .....	2
Referrals declined during the period .....	1
Referrals accepted during the period .....	3
Pending at the end of the period .....	1
Indictments and informations this period resulting from criminal referrals .....	2
Guilty Pleas .....	1
Sentencing .....	1

### Investigative Activities

Inspector General subpoenas issued.....	37
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### Personnel Actions

Separation from employment .....	9
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**Monetary Results**

Restitution .....	\$35,116
Fine .....	\$10,000
LSC decisions to disallow costs based on referrals from prior periods and referrals from this period .....	\$45,490
Total .....	\$90,606

**Metrics**

Data reflected in the statistical summary were compiled based on direct counts.

## **OTHER OIG ACTIVITIES**

### **Legislative, Regulatory, and Policy Reviews**

Pursuant to our 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.

LSC Regulations. As previously reported (Semiannual Report for the period ending September 30, 2015), the OIG recommended that LSC engage in rulemaking concerning 45 CFR Part 1629, Bonding of Recipients. To protect LSC grantees from loss caused by misappropriation of funds, we recommended that the provision requiring coverage only on those individuals who handle program funds or property be revised to require that grantees carry fidelity bond coverage for all their directors and employees. LSC instituted the rulemaking process and recently issued its final rule, making the change recommended by the OIG, as well as additional beneficial revisions. The new rule became effective September 8, 2017; LSC recipients and sub-recipients must comply with the rule by December 31, 2017.

LSC Policies. LSC is in the process of revising the criteria used to evaluate the quality of legal assistance provided by its grantees. In response to management's request for comment, the OIG reviewed the proposed revisions to LSC Performance Criteria, Performance Area 4, "Effectiveness of governance, leadership, and administration." LSC is proposing substantial modification to the language of the current indicators and areas of inquiry.

We provided detailed comments to LSC management, addressing the criteria related to board governance, leadership, technology and infrastructure, financial administration, human resources, and overall management and administration. Our comments focused on strengthening fiscal oversight, operational and resource management, and information technology security.

### **Freedom of Information Act**

The OIG is committed to complying fully with the requirements of the Freedom of Information Act (FOIA). During this reporting period, the OIG received one FOIA request; we responded within the requisite timeframe.

### **Professional Activities and Assistance**

The OIG participates in and otherwise supports various activities and efforts of the Council of the Inspectors General on Integrity and Efficiency (CIGIE), as well other inter-agency and professional groups. The IG serves as a member of the CIGIE Audit

Committee, which focuses on government auditing standards and cross-cutting audit issues.

Senior OIG officials are active participants in IG community peer groups in the areas of audits, investigations, inspections and evaluations, public affairs, new media, and legal counsel. The groups provide forums for collaboration and are responsible for such initiatives as developing and issuing professional standards, establishing protocols for and coordinating peer reviews, providing training programs, and promulgating best practices. The OIG also routinely responds to requests for information or assistance from other IG offices.

## **APPENDIX – PEER REVIEWS**

The following information is provided pursuant to the requirements of section 5(a) of the Inspector General Act of 1978, as amended, 5 U.S.C. App. 3 §5(a)(14)(A):

A peer review of the OIG was conducted this period by the Office of the Special Inspector General for Afghanistan Reconstruction. A system review with a rating of “pass” was issued on August 14, 2017.



**TABLE I**  
**Audit Reports, Other Reports, and Quality Control Reviews**

**Part A**  
**Audit Reports**

<u>Report Title</u>	<u>Date Issued</u>	<u>Questioned Costs</u>	<u>Funds Put to Better Use</u>	<u>Unsupported Costs</u>
Report on Selected Internal Controls – North Mississippi Rural Legal Services, Inc.	7/10/2017	\$0	\$0	\$0
Report on Selected Internal Controls – West Tennessee Legal Services, Inc.	7/11/2017	\$0	\$0	\$0
Report on Selected Internal Controls – Utah Legal Services, Inc.	8/24/2017	\$0	\$0	\$0
Report on Selected Internal Controls – Legal Services of Southern Missouri	9/28/2017	\$0	\$0	\$0
Report on Selected Internal Controls – Legal Aid Society of Northeastern NY, Inc.	9/29/2017	\$0	\$0	\$0

**TABLE I**  
**Part B**  
**Quality Control Reviews**

	<b><u>IPA</u></b>	<b><u>Recipient</u></b>	<b><u>Date Issued</u></b>
1	Plante & Moran, PLLC	Legal Aid of Western Michigan	4/17/2017
2	Blum, Shapiro & Company, P.C.	Statewide Legal Services of Connecticut, Inc.	5/18/2017
3	RSM US LLP	Northeast New Jersey Legal Services Corporation	8/30/2017
4	David G. Faw, CPA	Legal Services Corporation of Delaware, Inc.	8/30/2017
5	Yeo & Yeo, P.C.	Michigan Indian Legal Services, Inc.	8/30/2017
6	Satty, Levine & Caicco, CPAs	Nassau/Suffolk Law Services Committee, Inc.	8/31/2017
7	RSM US LLP	Legal Services NYC	9/5/2017
8	SVA Certified Public Accountants, S.C.	Prairie State Legal Services, Inc.	9/14/2017
9	Wegner CPAs, LLP	Wisconsin Judicare, Inc.	9/25/2017
10	Barnes Wendling CPAs, Inc.	The Legal Aid Society of Cleveland	9/29/2017
11	Brady, Martz & Associates, P.C.	Legal Services of North Dakota	9/29/2017

## TABLE II

### Audit Reports Issued with Questioned Costs

	<u>Number of Reports</u>	<u>Questioned Costs</u>	<u>Unsupported Costs</u>
A. For which no management decision has been made by the commencement of the reporting period.	1	\$32,614	\$0
B. Reports issued during the reporting period	0	\$0	\$0
Subtotals (A + B)	1	\$32,614	\$0
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	1	\$32,614	\$0
Reports for which no management decision had been made within six months of issuance	1	\$32,614	\$0

### TABLE III

#### Audit Reports Issued with Funds to Be Put to Better Use

	<u>Number of Reports</u>	<u>Dollar Value</u>
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
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
For which no management decision had been made within six months of issuance	0	\$0

## TABLE IV

### (A) 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>Comments</u>
Legal Aid Society of Eastern Virginia	9/27/16	The grantee partially responded to four recommendations and disagreed with taking corrective action for three recommendations. The OIG referred the seven outstanding recommendations to LSC management for resolution.
Neighborhood Legal Services Program of DC	3/28/17	The grantee was not responsive to two recommendations. The OIG referred two of the seven outstanding recommendations to LSC management for resolution. LSC management is working with the grantee to resolve the pending issues.

## TABLE IV

### (B) Audit Reports Issued Before this Reporting Period with Unimplemented Recommendations as of the End of the Reporting Period

<u>Report Title</u>	<u>Date Issued</u>	<u>Findings Summary<sup>1</sup></u>	<u>Comments</u>
Rhode Island Legal Services, Inc.	3/30/16	A, E	Corrective action in process.
Memphis Area Legal Services, Inc.	6/16/16	B	Corrective action in process.
Legal Aid Society of Eastern Virginia	9/27/16	A, B, C, E	Corrective action in process. LSC management is working to resolve all seven remaining open recommendations.
Legal Aid of Southeastern Pennsylvania	9/28/16	A, B, C, D, H	Corrective action in process.
DNA People's Legal Services	9/30/16	A, C, D, E, G, K, L	Corrective action in process.
Southwestern Pennsylvania Legal Services, Inc.	12/20/16	A, B, D, J	Corrective action in process.
Essex-Newark Legal Services	3/9/17	A, C	Corrective action in process.
Legal Aid Services of Oklahoma, Inc.	3/23/17	A, B, C, D, G, J	Corrective action in process.
Neighborhood Legal Services Program of DC	3/28/17	A, D, F, G	Corrective action in process. LSC management is working to resolve two of the seven remaining open recommendations.

**Legend:**

A = Written Policies & Procedures	B = Disbursements	C = Contracting	D = Fixed Assets	E = Derivative Income
F = Credit Cards	G = Cost Allocation	H = General Ledger & Financial Controls	I = Client Trust Funds	J = Segregation of Duties
K = Internal Reporting & Budgeting	L = Accounting System Access	M = Vehicles	N = Job Descriptions	O = Employee Benefits

<sup>1</sup>There are no quantified potential cost savings associated with these open recommendations.

## TABLE V

### Index to Reporting Requirements of the Inspector General Act

<u>IG Act Reference*</u>	<u>Reporting Requirement</u>	<u>Page</u>
Section 4(a)(2)	Review of and recommendations regarding legislation and regulations.	27
Section 5(a)(1)	Significant problems, abuses, and deficiencies.	3-12, 18-23
Section 5(a)(2)	Recommendations with respect to significant problems, abuses, and deficiencies.	3-12
Section 5(a)(3)	Prior significant recommendations on which corrective action has not been completed.	34
Section 5(a)(4)	Matters referred to prosecutive authorities.	18-19, 24
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.	29
Section 5(a)(7)	Summary of each particularly significant report.	3-12
Section 5(a)(8)	Statistical table showing number of audit reports and dollar value of questioned costs.	31
Section 5(a)(9)	Statistical table showing number of reports and dollar value of recommendations that funds be put to better use.	32
Section 5(a)(10)(A)	Summary of each audit issued before this period for which no management decision was made by the end of the period.	33
Section 5(a)(10)(B)	Audit reports with no establishment comment within 60 days.	None
Section 5(a)(10)(C)	Audit reports issued before this period with unimplemented recommendations as of the end of the period.	34
Section 5(a)(11)	Significant revised management decisions.	None
Section 5(a)(12)	Significant management decisions with which the Inspector General disagrees.	None
Section 5(a)(14)-(16)	Peer reviews.	28

Section 5(a)(17)-(18)	Statistical tables on investigations.	24-25
Section 5(a)(19)	Investigations involving senior employees where allegations of misconduct are substantiated.	None
Section 5(a)(20)	Instances of whistleblower retaliation.	None
Section 5(a)(21)	Attempts by the establishment to interfere with OIG independence.	None
Section 5(a)(22)	Specified matters closed and not disclosed to the public.	None

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





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