

# LEGAL SERVICES CORPORATION



Office of  
Inspector General



Semiannual Report to the Congress  
October 1, 2011 – March 31, 2012

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

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

**A MESSAGE FROM THE INSPECTOR GENERAL**

I am pleased to submit this report on the activities and accomplishments of LSC's Office of Inspector General (OIG) for the period October 1, 2011 through March 31, 2012.

During this reporting period we conducted audits relating to the adequacy of internal controls, particularly with respect to grantee financial operations, and relating to grantee expenditures and accomplishments under LSC's Technology Initiative Grant program. Audits completed during the period identified a total of nearly \$100,000 in questioned costs.

The Corporation's 2011 financial statement audit was issued during the period. The auditors found the financial statements presented fairly, in all material respects, LSC's financial position. However, in an accompanying report, the auditors did identify a significant deficiency in internal control over financial reporting that led to accounting errors requiring adjustments of over \$1 million. Management responded that the questioned accounting methodology had been consistently agreed to by previous auditors, but took appropriate corrective action.

This period marked the completion of the first full year of our Quality Control Review (QCR) initiative, designed to improve oversight of the independent audits required annually of LSC grantees. All firms performing grantee audits are now subject to a QCR at least once every four years. This period we issued 29 QCRs. Fifteen QCRs triggered a need for further review; in four cases the audits were found to have not met requisite standards. We provided a summary report of the full year's QCR findings to all firms performing grantee audits and to all executive directors to inform them of the problems identified and to help prevent such problems from occurring in the future.

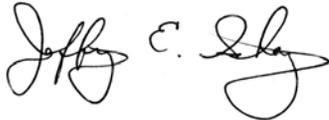
We opened 22 new investigations and closed 16 investigations during the reporting period. Among the investigations were criminal cases, involving fraudulent activity and financial irregularities by grantee employees, and regulatory matters, including grantee attorneys conducting outside law practices from their program's offices. In a significant case arising from an earlier OIG investigation, two former grantee employees were convicted and sentenced on guilty pleas to

wire fraud and theft of federal funds. The two had stolen nearly \$160,000 in grant funds.

We continued to emphasize outreach and educational initiatives as part of our ongoing efforts to help prevent fraud and abuse in LSC-funded programs. In addition to maintaining an active schedule of fraud awareness briefings, we launched a new program of regulatory vulnerability assessments, working on-site with grantees to identify internal control or compliance weaknesses that could potentially lead to bigger problems. We also presented a webinar on travel and timekeeping fraud (two areas where grantees have been frequently victimized) and issued advisory memoranda regarding information security breaches and counterfeit and altered check frauds involving grantees.

I wish to express my continuing appreciation to LSC's 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  
April 30, 2012

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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 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.

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 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, to gain access to all necessary documents and information, and to report OIG findings and recommendations to LSC management, its Board of Directors, and 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 and may address more general or systemic issues.

To be effective, the OIG works cooperatively with the Board and management of LSC, 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

During this reporting period, the OIG issued two audit reports, discussed below. The OIG also provided oversight for the LSC Fiscal Year (FY) 2011 financial statement audit and transmitted the final audit report to the LSC Board of Directors. In addition, the OIG issued two draft audit reports to grantee management for comment. Work in progress at the end of the reporting period included audits at six grantees. Two of these audits were in the draft report stage; field work was in progress for the remaining four. Additional audits were in the planning stage.

The OIG has responsibility for overseeing the independent public accountant (IPA) audits performed annually at each grantee. During the reporting period, the OIG reviewed 22 IPA reports, with fiscal years ending from June 30, 2011 through September 30, 2011.

The OIG also issued 29 quality control review (QCR) reports this period under our QCR initiative and published a summary of the findings for use by IPAs in planning future work. The goal of this initiative is to improve the overall quality of the audits and to ensure that all audits are conducted in accordance with applicable standards and with the guidance provided by the OIG. The OIG required the IPAs for 15 of the audits reviewed to provide further documentation. Four of the audits were found not to have met requisite standards. We will be evaluating the information provided and monitoring action by the IPAs in response to the reviews.

The OIG also conducted a review of another IG organization's system of quality control over audits. Our two offices entered into an agreement for each to review the other's system of control over audits on an annual basis. We believe this will help ensure that the control systems are operating as designed and better enable us to catch and correct any deficiencies that may arise. While all OIG organizations undergo a peer review every three years, it is incumbent upon each OIG to monitor its systems continuously. This agreement and the associated reviews represent an extra level of effort to ensure this requirement is met.

### **North Mississippi Rural Legal Services, Inc. – Audit Of Selected Internal Controls**

The OIG assessed the adequacy of selected internal controls in place at North Mississippi Rural Legal Services, Inc. (NMRLS) related to grantee operations and oversight, in particular those relating to program expenditures, fiscal accountability, and compliance with selected LSC regulations.

We found that although some controls needed to be strengthened, internal controls reviewed at NMRLS were generally adequate. Disbursements tested were, for the most part, found to be adequately supported, allowable, and properly allocated to LSC.

Internal controls over compliance with the provisions of 45 C.F.R. Part 1617 were found to be adequate. We did find, however, several issues that needed management attention, as discussed more fully in the report.

The OIG found that:

- One employee was paid with LSC funds to work in two positions for the grantee, but time records did not adequately support the time required of both positions.
- One attorney was performing duties under two separate grants but not keeping adequate time records showing the work performed under one of the grants.
- The grantee did not obtain LSC's prior approval for a purchase exceeding \$10,000 in LSC funds.
- The grantee needed to formalize a cost sharing agreement it had with another LSC grantee and reconcile shared expenses more timely with the other LSC grantee.

As a result of our findings, we questioned \$17,351 charged to LSC funds because the grantee did not obtain LSC's prior approval for the purchase that exceeded \$10,000 in LSC funds.

Other issues noted included the need to improve recordkeeping procedures for donated and disposed property; establish controls over approval of travel for the executive director; update the grantee's accounting manual to address contracting policies and procedures; and update the personnel manual to reflect current practices and policies.

The OIG made 12 recommendations. Two of the recommendations addressed controlling dual compensation and timekeeping. We also recommended that the grantee establish controls to ensure that major purchases are approved by LSC in advance; formalize in writing a shared expense agreement with another LSC grantee and obtain monies owed by the other grantee; and properly document donated assets and the disposal of assets. Two recommendations addressed improving controls over the executive director's travel. Other recommendations suggested that the grantee's policies and procedures be strengthened by including the policies used for contracting in the accounting manual and by including current personnel practices in the personnel manual.

Grantee management's actions taken or planned were responsive to all 12 of the recommendations. Six of the 12 recommendations will remain open until all stated grantee management actions are completed and appropriate written notification is provided to the OIG.

The grantee disagreed with the finding that the purchase of their accounting system (the subject of the \$17,351 questioned cost) required prior LSC approval as it exceeded \$10,000. The grantee stated that since the purchase was not a single purchase, but three separate purchases of items under \$10,000, LSC regulations and guidance did not require the grantee to obtain prior LSC approval.

The OIG disagreed with the grantee comments. While the grantee did make three separate purchases, the items purchased were all part of obtaining an individual item – an accounting system. We concluded that the three purchases were more than related items, but were components necessary for the system to work properly. The grantee had a contract for the accounting system that included multiple items, including software, training, set-up, transfer of data, etc.; all were necessary elements of the system. Since the cost of the accounting system exceeded \$10,000, we concluded that prior approval was required under LSC regulations and guidance. Despite their disagreement with the questioned cost finding, grantee management agreed with the underlying recommendation and indicated they would make appropriate changes to their purchasing policies and procedures.

### **Audits of Technology Initiative Grants**

As reported in our last report to Congress, the OIG has begun audits of grantees receiving Technology Initiative Grants (TIGs). The audits focus on whether TIG expenditures were allowable and supported, and whether the stated purposes of the TIG have been achieved. This initiative is a follow-on to our FY 2011 audit report on the TIG program at LSC headquarters.

Because LSC does not normally maintain information on the actual expenditures charged to these grants, the OIG obtained expenditure information from grantees on completed and terminated TIGs. To determine which TIGs to review the OIG analyzed the information provided on 120 grants, valued at a total of just under \$9 million, awarded to 65 separate grantees. We will conduct a field visit to the grantee for each grant selected for review. Since the TIGs selected for review have been closed, our reports are directed to LSC management rather than to the individual grantee. We do, however, provide our draft findings to grantee management and invite their comments as part of our report preparation process.

Our reports will provide an opinion on the expenditures charged to the grant, refer any questioned costs to LSC management, if necessary, and render a conclusion as to whether the stated purpose of the grant had been accomplished. In addition, to the extent we can identify potential improvements to the overall program or areas for strengthening grant oversight, appropriate recommendations will be made to LSC management.

This reporting period the OIG issued one report, described below, and initiated audits on two other TIGs.

## **Examination of Expenditures Incurred for the Performance of TIG Grants Awarded to the Center for Arkansas Legal Services**

The OIG examined expenditures incurred for the performance of TIGs awarded to the Center for Arkansas Legal Services (CALs). The objectives of the examination were to determine whether the expenditures for seven CALs TIGs totaling \$240,000 were allowable and whether the stated purposes of the TIGs were achieved.

The OIG concluded that the stated purposes of the seven TIGs appeared to have been met. However, the OIG also concluded that for four grants, \$82,300 of personnel and fringe benefit expenditures were not supported by adequate documentation as required by TIG assurances. (As a condition of receiving a TIG, each grantee executes a grant assurance document, undertaking to comply with specified terms and conditions of the grant.) TIG assurances reference LSC regulations and guidelines that describe documentation requirements for supporting costs. The accurate determination of TIG project costs is important since TIG assurances also require that funds provided in excess of project costs be returned to LSC or reprogrammed to other projects with the approval of LSC.

The grantee's response indicated that LSC management never provided written instructions showing that labor hours were to be used to distribute expenses to its TIGs based on personnel activity reports or timekeeping. However, we noted that TIG assurances require compliance with LSC regulations, guidelines, and directives that do provide specific written instructions about timekeeping requirements. As a result of the audit, the OIG referred \$82,300 in questioned costs to LSC management.

### **FY 2011 Corporate Audit**

The FY 2011 LSC financial statement audit report was issued this reporting period and transmitted to LSC's Board of Directors. The Corporation's financial statement audit is conducted by an independent public accounting firm under contract to and subject to general oversight by the OIG. The OIG reviewed the work of the IPA and found it in compliance with generally accepted government auditing standards.

The *Independent Auditor's Report* stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2011, and the results of its operations and changes in its fund balance for the year then ended. The auditor's *Report on Internal Control over Financial Reporting and on Compliance and Other Matters*, accompanying the financial statement audit report, did identify a significant deficiency dealing with LSC's methodology in accounting for receivables.

The auditor noted a deficiency in the design of controls relating to management's assertion that receivables are properly valued in the financial statements in accordance with generally accepted accounting principles (GAAP). The auditor found that LSC did not have in place a control that was designed to meet this control objective. This

deficiency affected both the FY 2010 financial statements and the FY 2011 statements. The auditor found that the receivable balance related to LSC's Loan Repayment Assistance Program (LRAP) was not properly adjusted to reflect management's estimate of the net realizable value. (The LRAP provides loan funding to repay student loan debt for individuals who work for LSC grantees and who meet certain eligibility requirements.) The auditor concluded that as a result, the accounts receivable balance was overstated, since the direct write-off method was being used rather than the allowance method, which is required by GAAP to more accurately represent future cash flows. Adjustments of more than \$1 million were required to properly reflect the current year's receivable balance.

The auditor recommended that LSC evaluate the receivable balance each year and adjust the allowance account to an appropriate amount based on its assessment of the current status of individual accounts. The auditor also recommended that management consider using a financial statement preparation and disclosure checklist when it prepares its annual financial statements.

LSC management stated that the same methodology had been used for LRAP accounting for both 2010 and 2011, and was also used for all prior years of the LRAP's existence. Management also stated that a significant annual reduction in loans receivable was made each year as recipients' balances have been forgiven. Management further stated that this methodology was discussed with its auditors in prior years, and the auditors agreed that it was appropriate. However, management did agree that it was appropriate to adjust the loan receivable balances to reflect management's estimate of the net realizable value, and that management will evaluate and adjust the receivable balance annually based on its assessment of the current status of individual accounts. The balances have been adjusted for FY 2010 and FY 2011, as recommended. The auditor concluded that management's proposed corrective actions were responsive to the finding.

## Statistical Summary

### Audit Reports

|   |                |
|---|----------------|
| Open at beginning of reporting period ..... | 4              |
| Issued during reporting period .....        | 3              |
| Closed during reporting period .....        | 2              |
| Open at end of reporting period.....        | 5 <sup>1</sup> |

### Recommendations to LSC Grantees

|   |    |
|---|----|
| Pending at beginning of reporting period..... | 19 |
| Issued during reporting period .....          | 12 |
| Closed during reporting period .....          | 7  |
| Pending at end of reporting period .....      | 24 |

### Recommendations to LSC Management

|   |    |
|---|----|
| Pending at beginning of reporting period..... | 24 |
| Issued during reporting period .....          | 1  |
| Closed during reporting period .....          | 14 |
| Pending at end of reporting period .....      | 11 |

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<sup>1</sup> Legal Aid of North Carolina responded to open recommendations on March 27, 2012. Grantee corrective actions were being evaluated as of the close of the reporting period.

## **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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The OIG provides guidance to the IPAs and grantees, as well as general oversight of the IPA process. Our oversight activities include desk reviews and a recently enhanced program of quality control 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 to LSC management significant IPA findings that require management's attention. We also track whether recommendations have been acted upon and appropriate actions taken by the grantee. In addition, we use information from this review of 100% of 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**

The OIG completed its first year of its new QCR initiative. The QCR initiative is a comprehensive program under which all IPA firms performing grantee audits will be subject to at least one QCR every four years. The QCRs determine whether the IPA's financial statement audit work, compliance audit work, and the associated review of internal controls over both financial reporting and compliance were conducted in accordance with applicable standards and in compliance with the instructions issued by this office. The reviews are conducted by a CPA firm under contract to the OIG. The contractor also identifies issues that may require additional attention or any additional audit work by the IPA under review.

### **Quality Control Reviews – First Year Results**

This reporting period the OIG issued 29 QCR reports to IPAs. The OIG issued seven QCRs last reporting period, for a combined total of 36 QCRs for the year. The QCRs

resulted in four audits being classified as not meeting standards. For 15 QCRs, the IPAs were required to provide the OIG with additional documentation to support the conclusions reached. For 20 QCRs, additional documentation was not required at this time, but the IPAs needed to ensure that additional steps were taken on future audits of LSC grantees. For one IPA, no deficiencies were noted in the QCR. The OIG will review all additional documentation required to be provided by the IPAs to ensure that LSC grantees receive an acceptable audit.

Only a limited range of issues was identified in connection with the financial review aspects of the QCRs. Moreover, the audit work related to the internal control and fraud analysis was found to be almost universally adequate. Most of the issues identified in the QCRs resulted from either inadequate documentation of the work performed or inadequate attention to certain requirements in the LSC Compliance Supplement.

### **Quality Control Reviews Advisory Memorandum**

In addition to the individual QCR reports, the OIG issued an advisory memorandum to all IPAs and grantee executive directors. The purpose of the advisory was to highlight the deficiencies identified so that this information can be used in planning and conducting future audits. We are hopeful that this will help in preventing similar types of deficiencies from occurring in the annual audits of LSC grantees.

The advisory memorandum, with a complete list of the specific deficiencies identified, can be found at our website ([www.oig.lsc.gov](http://www.oig.lsc.gov)) under the heading, "Advisory to Executive Directors and Grantee Public Accountants, Quality Control Reviews."

### **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 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, 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 identified below reflect the work of the IPAs, not the OIG.

During the reporting period, the OIG reviewed 22 audits of grantees with fiscal year ending dates from June 30, 2011 through September 30, 2011. These audit reports contained seven findings. The OIG reviewed the findings and determined that all seven findings were either not significant or that corrective action had already been completed, and closed the findings. No findings in the grantee audit reports for fiscal years ending from June 30, 2011 through September 30, 2011 were referred to LSC management for follow-up.

## **INVESTIGATIONS**

The OIG opened 22 investigations during this reporting period. These included 9 criminal investigations, 4 compliance matters, 4 fraud vulnerability assessments, and 5 regulatory vulnerability assessments. The criminal investigations included allegations of fraudulent activity and financial irregularities. The compliance investigations included allegations of violations of LSC statutes and regulations involving matters such as the outside practice of law and retaliation.

During the reporting period the OIG closed 16 investigations. These included 3 criminal investigations, 7 compliance matters and 6 fraud vulnerability assessments. The OIG also issued 13 Inspector General subpoenas in connection with our ongoing work.

### **Criminal Proceedings**

#### **Guilty Pleas and Sentencing**

##### **Former Grantee Employees Plead Guilty and Are Sentenced for Theft of Nearly \$160,000 in Grant Funds**

The former office manager of U'una'i Legal Services Corporation of American Samoa, a now-defunct LSC grantee, and her daughter, who was employed as a paralegal at the grantee, entered guilty pleas in U.S. District Court for the Northern District of California, pursuant to plea agreements with the U.S. Department of Justice (DOJ). The office manager pled guilty to one felony count of wire fraud and the daughter pled guilty to one misdemeanor count of theft of federal funds.

As part of their plea agreements, the office manager and her daughter admitted to their roles in defrauding the grantee. The office manager admitted to making and receiving unlawful payments from federal grant funds, including paying numerous unlawful "salary advances" to herself, her daughter, and the then executive director of the grantee. The office manager created false time records and took other steps to avoid repayment of the ostensible salary advances. The office manager also admitted to placing other family members on the grantee's payroll for jobs not permitted by the grants and to benefitting from the pay that her family members received.

The office manager was sentenced to 12 months and one day imprisonment, to be followed by 3 years supervised release. Her daughter was sentenced to 12 months probation, including 6 months house detention. Both were ordered to provide specified hours of community service throughout their terms of probation. In addition, both were ordered to make full restitution of the moneys stolen from the grantee in the amount of \$159,763, for which they are to be jointly and severally liable.

The former executive director of the program, also a participant in the scheme, previously pled guilty to theft of federal grant funds and was awaiting sentencing as of the close of the reporting period. This prosecution resulted from a joint investigation by the OIG and DOJ OIG, with assistance from the FBI.

## **Personnel Actions**

### **Two Grantee Attorneys Found to Have Unauthorized Outside Law Practices**

The OIG received information from a confidential source indicating that two attorneys working for an LSC grantee had unauthorized outside law practices. LSC regulations and the grantee's outside employment policy prohibit employees from engaging in the outside practice of law, except when the representation meets specified criteria and permission is granted by the executive director. The OIG conducted an investigation and determined that for several years both attorneys, without proper authorization and in violation of LSC regulations, had been conducting outside practices.

One individual was a managing attorney for the grantee; the other was a staff attorney. Both attorneys, without the knowledge of the executive director, had provided services to private clients, including guardian-ad-litem services in court-appointed cases. The managing attorney also sat as a court-appointed divorce master. Both attorneys received compensation for their outside work and worked on the matters during grantee office hours. The attorneys also used the grantee's name and address on pleadings for their private cases, in violation of LSC regulations. The staff attorney was also found to have used the grantee's support staff to draft and sign pleadings for his private clients. The two attorneys were terminated by the grantee.

### **Grantee Employee Admits to Misuse of Funds Paid as Benefits**

A grantee reported that one of its paralegals improperly kept her ex-spouse enrolled under her employer's medical plan by failing to report her divorce to the grantee's human resources office. The OIG conducted an investigation and determined that the grantee spent \$3,975 in health insurance premiums for the ex-spouse over a 9-month period. During an interview with the OIG, the employee admitted neglecting to report her divorce and acknowledged responsibility for repayment of the funds to the grantee. The employee signed a promissory note to reimburse the grantee the full amount owed plus interest, with payments to be made through payroll deductions over a two year period.

## **Proactive and Preventive 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 and fraud

vulnerability assessments, as described below, and provide fraud alerts and other information that we believe will help increase grantees' awareness of potential vulnerabilities. Also during this reporting period the OIG introduced a new preventive initiative, regulatory vulnerability assessments, discussed below.

### **News Reports Indicate Violation of LSC Regulations**

Recently, the OIG identified several news articles indicating that a grantee attorney had engaged in a public demonstration, which is prohibited by LSC regulations (45 CFR §1612.7). The OIG sent a letter to the program requesting additional information. In response, the program admitted that there had been a violation and took prompt corrective action, including requiring program-wide training on the relevant LSC regulations.

### **Fraud Awareness Briefings**

Fraud awareness briefings (FABs) are presented by OIG investigators and cover topics such as 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.

While individuals at LSC-funded programs may be generally aware that fraud and abuse can occur at any organization, they may not be aware of the potential for such incidents to occur "close to home," within their own programs. Moreover, program staff often may think that if there is such wrongdoing, it must be minimal. Our briefings highlight the unfortunate truth that in recent years a number of LSC-funded programs have been victimized by frauds involving hundreds of thousands of dollars, and even 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.

LSC grantees are invited to request a fraud awareness briefing at a time and place convenient to them. We make every effort to accommodate requests as promptly as possible. We encourage attendance by all program staff and welcome the grantee's board members, their IPAs, and other interested parties.

This reporting period the OIG conducted eight fraud awareness briefings for LSC-funded programs in Florida, Mississippi, Oklahoma (two), Delaware, California (two), and Arkansas.

## **Webinar and Podcast on Timekeeping and Travel Fraud Prevention**

Due to the interest shown by several grantees in the OIG's September 30, 2011 fraud alert, *Advisory Bulletin on How to Prevent and Detect Fraudulent Travel and Timekeeping Submissions*, the OIG developed a webinar presentation to provide grantees with additional information on how to prevent timekeeping and travel fraud. The webinar was presented on December 13, 2011. The OIG invited staff from all LSC programs to participate. Based on the positive feedback we received after the webinar presentation, the OIG posted the slides and a podcast recording of the presentation on our website.

## **Fraud Vulnerability Assessments**

The OIG's fraud vulnerability assessments (FVAs) are conducted on-site at individual grantee's offices and consist of a focused document review in any areas considered weak or prone to abuse and a review of grantee internal control policies and the degree to which those policies are observed in practice. We also brief the executive director and principal financial officer on fraud detection and prevention measures keyed to their particular program. The FVAs can help grantees identify both existing vulnerabilities and potential problem areas.

We continued our project to analyze per capita costs in program travel and office supply expenditures, areas that have often been focal points for diversion of program funds, and to conduct FVAs at programs with apparent anomalies in their spending patterns. Project findings are incorporated into the FVA program on an on-going basis.

Six FVAs were completed during the reporting period, including three that were begun during the prior period.

## **Regulatory Vulnerability Assessments**

During the reporting period, the OIG initiated a pilot program of regulatory vulnerability assessments (RVAs). RVAs are conducted on-site at individual grantee's offices. This initiative was triggered by our experience in recent years in investigating numerous financial frauds in which grantees have been victimized. We often found that the failure to comply with, or laxity with respect to, certain LSC regulations, grant assurances, provisions of the Accounting Guide, and case documentation and reporting requirements (as set forth in the Case Service Report handbook) contributed to an environment that increased the potential for fraud. This was also, in part, the subject of our recent fraud alert (September 30, 2011), highlighting common internal control weaknesses and pointing out that compliance with specified requirements could help prevent several recurring types of fraud. We believe that by focusing on certain key areas, in addition to identifying potential problems from a strictly regulatory compliance

point of view, grantees might also benefit by applying the classic “ounce of prevention” to areas where there is the potential for broader financial vulnerabilities.

During the reporting period, the OIG completed field work on one RVA and initiated four additional RVAs. The completed RVAs will be reported in the next reporting period.

### **Fraud Alert**

During the reporting period, a fraud alert was issued to inform grantees of several checking account frauds perpetrated against LSC grantees. The frauds involved several instances of grantee checks being either counterfeited or altered. In the counterfeit check schemes individuals had designed, printed, and negotiated counterfeit checks that contained the grantee’s correct checking account and bank routing numbers. The altered check schemes involved legitimate grantee checks that were altered by changing the payee or amount of the checks and negotiating the checks. The fraud alert informed grantees of methods to prevent counterfeit and altered check fraud and the actions that grantees should take in the event counterfeit or altered checks are identified. The OIG also provided grantees with reference material to assist in preventing and detecting these types of schemes.

### **Hotline**

The OIG maintains a Hotline for reporting illegal or improper activities by LSC grantees or Corporation staff. Information may be provided by telephone, fax, email, or mail. Upon request, a provider’s identity will be kept confidential. Reports may also be made anonymously. During this reporting period, the OIG received 98 Hotline contacts (compared to 62 for the previous period). Of these matters, 10 were referred to LSC management for follow-up; 13 were opened as investigations; 3 are open pending further inquiry; and the remaining 72 were closed.

## Statistical Summary

### Investigative Cases

|                                       |    |
|---------------------------------------|----|
| Open at the beginning of period ..... | 18 |
| Opened during the period.....         | 22 |
| Closed during period .....            | 16 |
| Open at the end of period.....        | 24 |

### Prosecutorial Activities

|                    |   |
|--------------------|---|
| Guilty pleas ..... | 2 |
| Sentencing .....   | 2 |

### Investigative Activities

|   |    |
|---|----|
| Inspector General subpoenas issued..... | 13 |
|---|----|

## **OTHER OIG ACTIVITIES**

### **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.

Among the most significant items addressed this period was the Notice of Proposed Rulemaking (NPRM) published by LSC on January 31, 2012, proposing amendments to LSC's regulations on termination procedures, enforcement, and suspension procedures. The OIG has had a long-standing interest in this subject matter, having made comparable recommendations to the Board of Directors and LSC management at various times over the past 10 years. In April 2007, the OIG recommended to the Board of Directors that LSC issue a regulation allowing for lesser sanctions and other tools to help ensure compliance with grant terms by providing enforcement options that would be both more streamlined and less severe than were otherwise available.

We believe the regulatory changes contemplated by the current NPRM will increase LSC's flexibility as a grant administrator and go a long way toward remedying shortcomings in LSC's existing enforcement mechanisms. We are providing detailed comments in response to the NPRM, including suggestions for further improvements to the proposed amendments to 45 CFR Parts 1618 and 1623. Subject to those recommendations, we support adoption of the regulations proposed in the NPRM.

### **Litigation**

On November 14, 2011, the United States District Court for the District of Columbia issued an order granting the OIG's petition for enforcement of a subpoena it had issued to California Rural Legal Assistance (CRLA). In a memorandum opinion accompanying the order, the court held, consistent with the position of the OIG, that state law privileges do not bar disclosure of information falling within Section 509(h) of LSC's appropriations act. That provision specifies that certain client identifying and other information is accessible by auditors and monitors of LSC recipients, including the OIG. The court further held that California professional responsibility rules do not prohibit disclosure of any of the information sought by the OIG and that state attorney-client or work product protections do not limit the information available pursuant to the OIG's subpoena.

The court held that the OIG's subpoena was issued for a lawful purpose and that the information sought was reasonably relevant to the OIG's investigative purpose. The court also concluded that OIG's proposed review protocol could allow for adequate privilege review of the electronic data sought by the subpoena without overburdening CRLA. The court acknowledged the sensitivity of the information sought and ordered the parties to submit a revised proposed protective order. Subject to this revised

protective order, the court enforced the subpoena as narrowed by agreement of the parties in the course of litigation and as requested by the OIG.

On December 13, 2011, CLRA appealed the district court's order granting enforcement of the OIG's subpoena. On January 12, 2012, the OIG filed a cross-appeal. The parties now await the establishment of a briefing and argument schedule for the appeal.

### **Advisory Memoranda**

During the reporting period, the OIG issued a grantee advisory memorandum to all executive directors to inform them of several instances of significant information security breaches that had occurred within the past few years. One instance involved the loss of extensive database information; another concerned the loss of client files. The grantee advisory stressed the importance of securing confidential information against both electronic breaches and physical theft. It also explained how compliance with specified LSC grant assurances and good IT security practices (detailed in the memorandum) could help grantees prevent such types of incidents from occurring in their own programs.

During the period the OIG transmitted a recommendation to the LSC president that, in light of the approaching elections, it would be advisable to remind LSC and grantee employees of the provisions of the LSC Act and the Hatch Act restricting certain political activities. LSC's president concurred with the recommendation and issued memoranda to LSC employees and executive directors of all LSC grantees to alert them to the relevant restrictions.

### **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 three FOIA requests; all were responded to within the requisite timeframes.

### **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 Inspector General 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, communications, 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 989C of Public Law 111-203 (July 21, 2010), the Dodd-Frank Wall Street Reform and Consumer Protection Act, amending the Inspector General Act of 1978 (the IG Act), 5 U.S.C. App 3. The references are to the newly added provisions of Section 5(a) of the IG Act.

(14)(B) – The last peer review of the OIG was conducted by the Corporation for Public Broadcasting, Office of Inspector General. A system review report with a rating of “Pass” was issued on September 30, 2011.

(15) – There are no outstanding recommendations from any peer review of the OIG conducted by another Office of Inspector General that have not been fully implemented.

(16) – No peer reviews were conducted by the OIG of another Office of Inspector General during the reporting period. The last peer review conducted by this office was of the National Railroad Passenger Corporation (Amtrak), Office of Inspector General’s Audits organization. The report was dated September 30, 2009. We have been advised by that office that a system has been developed and is fully operational that accurately tracks required continuing professional education (CPE) credits. There are no recommendations outstanding or not fully implemented.

## TABLE I

### Audit Reports and Quality Control Reviews Issued for the Period Ending March 31, 2012

#### Audit Reports

| <u>Report Title</u>  | <u>Date Issued</u> | <u>Questioned Costs</u> | <u>Funds Put to Better Use</u> | <u>Unsupported Costs<sup>1</sup></u> |
|--|--------------------|-------------------------|--------------------------------|--------------------------------------|
| Legal Services Corporation FY 2011 Financial Statement Audit Report  | 01/19/12           | \$0                     | \$0                            | \$0                                  |
| Examination of Expenditures Incurred for the Performance of TIG Grants Awarded to Center for Arkansas Legal Services | 02/27/12           | \$82,300                | \$0                            | \$82,300                             |
| Report on Selected Internal Controls – North Mississippi Rural Legal Services  | 03/30/12           | \$17,351                | \$0                            | \$0                                  |

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<sup>1</sup> Unsupported costs are a subset of questioned costs and included in the question cost amount.

## Quality Control Reviews

|    | <u>IPA</u>                    | <u>Recipient</u>             | <u>Date Issued</u> |
|----|-------------------------------|------------------------------|--------------------|
| 1  | Drees, Risky & Vallager       | LS Northwest Minnesota       | 12/15/11           |
| 2  | Drees, Risky & Vallager       | Anishinabe LS                | 12/15/11           |
| 3  | McGee, Hearne & Paiz          | LA of Wyoming                | 01/17/12           |
| 4  | Saunders & Associates         | LAS of Oklahoma              | 01/17/12           |
| 5  | Vachon Clukay & Co.           | Legal Advice & Referral Ctr. | 01/17/12           |
| 6  | Eide Bailly                   | East River LSC               | 01/17/12           |
| 7  | Justin J. Scanlan, CPA        | Southeast Louisiana LSC      | 01/17/12           |
| 8  | McCauley, Nicolas & Co.       | Legal Aid Society            | 01/17/12           |
| 9  | Ketel Thorstenson             | Dakota Plains LS             | 01/17/12           |
| 10 | DeVries CPAs of Arizona       | Southern Arizona LA          | 02/03/12           |
| 11 | Carr, Riggs & Ingram          | Three Rivers LS              | 02/03/12           |
| 12 | Marks Nelson Vohland Campbell | LA Western Missouri          | 02/03/12           |
| 13 | Daniel Dennis & Co.           | Volunteer Lawyers            | 02/03/12           |
| 14 | Mauldin & Jenkins             | George LSP                   | 02/03/12           |
| 15 | J. Miller & Associates        | LA Southeastern Penn         | 02/16/12           |
| 16 | J. Miller & Associates        | Southwestern Penn LS         | 02/16/12           |
| 17 | J. Miller & Associates        | Laurel LS                    | 02/16/12           |
| 18 | J. Miller & Associates        | Neighborhood LS              | 02/16/12           |
| 19 | Cole & Reed                   | Oklahoma Indian LS           | 02/16/12           |
| 20 | Sanders & Associates          | Idaho LAS                    | 02/16/12           |
| 21 | Banks, Finley, White & Co.    | Mississippi Ctr. for LSC     | 02/16/12           |
| 22 | Cowart Reese Sargent CPAs     | West Tennessee LS            | 02/16/12           |
| 23 | Bernard J. Egan, CPA          | South Jersey LS              | 02/16/12           |
| 24 | Burt and Company              | New Mexico LA                | 02/16/12           |
| 25 | Lawrence B. Goodman & Co.     | Northeast New Jersey LSC     | 02/27/12           |
| 26 | Walker & Co.                  | Legal Aid Bureau             | 02/28/12           |
| 27 | VonLehman & Company           | LA of Bluegrass/Northern KY  | 03/09/12           |
| 28 | BKD, LLP                      | Cumberland Trace/Kentucky LA | 03/09/12           |
| 29 | TCBA Watson Rice              | LS Greater Miami             | 03/09/12           |

## TABLE II

### Audit Reports Issued with Questioned Costs for the Period Ending March 31, 2012

|  | <u>Number<br/>of<br/>Reports</u> | <u>Questioned<br/>Costs</u> | <u>Unsupported Costs<sup>1</sup></u> |
|--|----------------------------------|-----------------------------|--------------------------------------|
| A. For which no management decision has been made by the commencement of the reporting period. | 3                                | \$292,163                   | \$227,685                            |
| B. Reports issued during the reporting period  | 2                                | \$99,651                    | \$82,300                             |
| Subtotals (A + B)  | 5                                | \$391,814                   | \$309,985                            |
| C. For which a management decision was made during the reporting period:                       | 3                                | \$292,163                   | \$227,685                            |
| (i) dollar value of recommendations that were agreed to by management                          | 3                                | \$54,575 <sup>2</sup>       | \$18,211                             |
| (ii) dollar value of recommendations that were not agreed to by management                     | 2                                | \$237,589                   | \$209,474                            |
| D. For which no management decision had been made by the end of the reporting period           | 2                                | \$99,651 <sup>3</sup>       | \$82,300                             |
| Reports for which no management decision had been made within six months of issuance           | 0                                | 0                           | \$0                                  |

<sup>1</sup> Unsupported costs are a subset of questioned costs and are included in the question cost amount.

<sup>2</sup> For two reports, grantee management provided evidence that before the questioned cost process was initiated or before it was complete the LSC account had been repaid. These amounts, \$27,600 and \$3,951, are included in the amount reported as agreed to by management.

<sup>3</sup> Questioned costs of \$17,351 for North Mississippi Rural Legal Services were formally referred to LSC management after the close of the reporting period.

### TABLE III

## Audit Reports Issued with Funds to Be Put to Better Use for the Period Ending March 31, 2012

|   | <u>Number of<br/>Reports</u> | <u>Dollar<br/>Value</u> |
|---|------------------------------|-------------------------|
| A. For which no management decision has been made by<br>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<br>reporting period:                       | 0                            | \$0                     |
| (i) dollar value of recommendations that were<br>agreed to by management                          | 0                            | \$0                     |
| (ii) dollar value of recommendations that were not<br>agreed to by management                     | 0                            | \$0                     |
| D. For which no management decision had been made by<br>the end of the reporting period           | 0                            | \$0                     |
| Reports for which no management decision had been<br>made within six months of issuance           | 0                            | \$0                     |

## TABLE IV

### Audit Reports Issued Before this Reporting Period for Which No Management Decision on Questioned Costs Was Made by the End of the Reporting Period

| <u>Report Title</u> | <u>Date Issued</u> | <u>Questioned Costs</u> | <u>Comments</u> |
|---------------------|--------------------|-------------------------|-----------------|
| None                | N/A                | N/A                     | N/A             |

### Audit Reports Issued Before this Reporting Period with Open Recommendations as of the End of the Reporting Period

| <u>Report Title</u>   | <u>Date Issued</u> | <u>Comments</u>   |
|---|--------------------|---|
| Audit of LSC's Technology Initiative Grant Program                                      | 12/08/10           | During this reporting period, 13 of 24 open recommendations were closed.  |
| Report on Selected Internal Controls: Appalachian Research and Defense Fund of Kentucky | 08/22/11           | Corrective action still in process of being implemented.  |
| Report on Selected Internal Controls: Legal Services of Northern Virginia, Inc.         | 09/30/11           | LSC management is working with the grantee to resolve all open recommendations.   |
| Report on Selected Internal Controls: Legal Aid of North Carolina, Inc.                 | 09/30/11           | Request to close all open recommendations was received on March 27, 2012. Information provided was being evaluated as of the close of the current period. |

## 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 legislation and regulations  | 18          |
| Section 5(a)(1)          | Significant problems, abuses, and deficiencies.  | 6-7         |
| Section 5(a)(2)          | Recommendations with respect to significant problems, abuses, and deficiencies.  | 6-7         |
| Section 5(a)(3)          | Prior significant recommendations on which corrective action has not been completed.   | 26          |
| 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. | 22-23       |
| Section 5(a)(7)          | Summary of each particularly significant report.   | 6-7         |
| Section 5(a)(8)          | Statistical table showing number of audit reports and dollar value of questioned costs.  | 24          |
| Section 5(a)(9)          | Statistical table showing number of reports and dollar value of recommendations that funds be put to better use.   | 25          |
| 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.  | 26          |
| 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.  | 21          |

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



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