LEGAL SERVICES CORPORATION

Office of
Inspector General

Semiannual Report to the Congress
October 1, 2013 – March 31, 2014

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, 2013, through March 31, 2014.

During this reporting period we performed audits focused on the adequacy of grantees' internal controls, particularly in the area of financial operations. We also engaged a contractor with specialized expertise to conduct a comprehensive risk assessment of LSC's information technology systems. While the risk assessment report identified significant deficiencies, including a large number of technical vulnerabilities, and found the overall risk level to be high, management responded positively, immediately initiating corrective actions and adopting an action plan to address all the report's recommendations.

The Corporation's 2013 financial statement audit report was issued during this period. No significant deficiencies or material weaknesses were identified. In an accompanying management letter the auditors identified an opportunity for strengthening LSC's internal controls and operating efficiency by improving LSC's process for preparing complete and accurate footnote disclosures. Management agreed to consider the auditors' recommendations.

We completed the third year of our initiative to provide enhanced oversight of the independent audits required annually of LSC grantees. Firms performing grantee audits are now subject to a Quality Control Review (QCR) at least once every four years. During the period we issued 17 QCRs. A total of 111 reviews have been completed under the program.

In addition to following up with individual audit firms and grantees after each review, we also issued our third advisory memorandum for all grantees' independent auditors and executive directors, summarizing the results of QCRs conducted over the preceding fiscal year, and identifying the principal exceptions and deficiencies found. We believe the advisory memoranda and the overall QCR process are beneficial in identifying any systemic issues and in helping prevent the repetition of similar problems in future audits.

We concluded debarment proceedings against one audit firm whose work failed to meet requisite standards and was found via a QCR to be so deficient as to warrant rejection of the audit report.

We opened 12 new investigations and closed eight investigations during the reporting period. Among the investigations were criminal cases, involving fraudulent activity and financial irregularities by grantee employees, and regulatory matters, including the unauthorized outside practice of law and time and attendance abuse. Cases arising from OIG investigations resulted in the restitution of client trust fund monies that had been converted to personal use and the recovery of more than $21,000 in LSC funds for time spent by a grantee's attorneys in unauthorized outside practice.

We continued to emphasize outreach and education as part of our ongoing efforts to help prevent fraud and abuse in LSC-funded programs. We maintained an active calendar of grantee outreach visits, completing a total of 17 fraud awareness briefings and two vulnerability assessments.

I am particularly pleased to report that our investigations office received an award for excellence from the Council of the Inspectors General on Integrity and Efficiency, and I am grateful for the recognition accorded this achievement by LSC's Board of Directors. I wish to express my continuing appreciation to all the members of the Board 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,

Jeffrey E. Schanz
Inspector General
April 30, 2014

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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 identify 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.

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 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 an 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 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 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 and may address more general or systemic issues.

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 to the poor.

AUDITS

As discussed below, during this reporting period the OIG issued two audit reports with respect to grantee operations and employed a specialized contractor to conduct a security risk assessment of LSC's information technology systems. We also provided oversight for LSC's Fiscal Year 2013 financial statement audit and transmitted the final audit report to the LSC Board of Directors. We issued two draft reports and one close-out letter. At the close of the period we had seven projects underway and in various stages of completion; an additional three grantee reviews were in the initial planning phase.

The OIG has responsibility for overseeing the independent public accountant (IPA) audits performed annually at each grantee. During the reporting period, the OIG reviewed 21 IPA reports, with fiscal years ending from June 30, 2013, through September 30, 2013.

The OIG also issued 17 Quality Control Review (QCR) reports this period under our QCR initiative and published our third advisory memorandum, which is a summary of findings for use by IPAs in planning future work. We completed QCRs on 35 grantee audits in 2013. 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 26 of the audits reviewed to provide further documentation or to complete additional audit work. We will be evaluating the information provided and monitoring the IPAs' corrective actions.

During the last reporting period, three QCRs identified deficiencies for which IPAs were required to provide the OIG additional documentation supporting the work performed or to perform additional audit work. The IPAs provided adequate documentation and performed the required additional work in response to all three of these QCRs.

Land of Lincoln Legal Aid Foundation – Audit of Selected Internal Controls

The OIG assessed the adequacy of selected internal controls at the Land of Lincoln Legal Aid Foundation (LOLLAF), East St. Louis, Illinois. We found that the grantee needed to place more emphasis on establishing and documenting some internal controls. While most of the controls were adequately designed and properly implemented as they related to specific grantee operations and oversight, some controls needed to be implemented, strengthened, or formalized in writing.

We reported that controls over access to the grantee's accounting system needed to be established. We found that all four members of the accounting staff and the executive director had unrestricted access within the accounting system. In addition, the system did not have the capability to create an audit trail to identify which employees input the various transactions within the system.

We also reported that controls over client trust funds (CTFs) needed to be strengthened or established. CTF receipt forms, used to record funds received, were missing certain elements that are required by LSC's Accounting Guide. Also, CTF processing duties in the field offices were not segregated.

We identified several equipment and property control issues. LOLLAF did not track non-capitalized information technology (IT) equipment. We were advised that the grantee relied on an IT contractor to track that equipment for them. However, the contractor stated that it was not its responsibility to track IT equipment for the program. We also found that the grantee did not conduct biannual physical inventories of capitalized property, as required by the "Fundamental Criteria" provisions of LSC's Accounting Guide.

We reported that LOLLAF needed to develop written policies and procedures related to budgeting and internal reporting, contracting, credit cards and derivative income. We did note that the practices actually in use for these areas were generally in accordance with LSC's Accounting Guide.

Grantee management agreed with all the findings and recommendations contained in the report. They stated that they had already begun examining new accounting system software, which they planned to install by mid-2014. With respect to CTF controls, grantee management stated that they have revised and implemented some new policies and procedures. They were considering moving local CTF accounting to a restricted portion of their new system or creating an independent system. Grantee management stated that they should have written policies and procedures on budgeting and internal reporting, contracting, credit cards, and derivative income approved before the end of 2014. Grantee management also advised that they will review all policies and procedures for property management to ensure that they address all required areas contained in LSC's Accounting Guide and, upon review of those policies, will conduct a conforming inventory.

The OIG considered management's comments responsive to the findings and recommendations contained in the report.

Appalachian Research and Defense Fund of Kentucky – Follow-up Audit

The OIG conducted a follow-up audit of significant issues identified during our previous audit (August 2011) of selected internal controls at the Appalachian Research and Defense Fund of Kentucky ("AppalReD"). Overall, we found that grantee management had corrected most of the findings and related issues identified in the original audit report.

The AppalReD Board of Directors implemented the previous audit's overall recommendation to retain a qualified individual to evaluate the internal control and accounting systems and implement changes necessary to correct the deficiencies we had identified. An experienced fiscal manager with an educational background in accounting and experience in managing an accounting department was hired and significant improvements were made to the grantee's internal control system, accounting system, and accounting department organizational structure. However, although the grantee had made significant progress in correcting the 12 findings reported, we found that four findings were not fully addressed:

1) Purchases over $500 were not processed in accordance with the grantee's accounting manual. Of the ten purchases of goods and services over $500 reviewed, six did not have the required competitive quotes documented. The grantee did maintain documentation such as invoices and check copies which support the purchases. However, the OIG could not determine the basis for the six purchase decisions.

The grantee did not have a policy requiring a written justification when a purchase for an item greater than $500 is made without obtaining the required number of quotes.

2) The grantee's accounting manual was updated in response to the OIG's original audit finding. However, five required policies were not included in the updated manual.

Specific areas missing from the grantee's accounting manual were:

- Budgeting;
- Student Loan Repayment Assistance Program (LRAP);
- Derivative Income;
- Travel; and
- Contracting.

3) While a cost allocation system was documented in the grantee's accounting manual, it was not the allocation system in use.

4) AppalReD's inventory listing from some of its branch offices did not contain all the elements called for by the LSC Accounting Guide's "Fundamental Criteria." Some of the property listings were missing elements such as the check number, funding source, and tag number.

Grantee management agreed in principle with all four of the findings and recommendations contained in the follow-up report.

The OIG considered management's comments responsive to the findings and recommendations contained in the report. The OIG considered three of the four recommendations closed. However, one of the recommendations was only partially addressed by the grantee's revisions to the accounting manual. This recommendation will remain open until policies and procedures related to LRAP and the budgeting process have been revised and approved by the grantee's board of directors.

Risk Assessment of LSC's Information Technology Systems

The purpose of this review was to assess the security risks associated with LSC's information technology (IT) systems, to determine whether LSC's IT systems were consistent with National Institute of Standards and Technology (NIST) standards and industry best practices, and to make recommendations for security controls to reduce any identified risk to acceptable levels. The OIG engaged the services of a specialized contractor to conduct the risk assessment.

The review was conducted in accordance with specifications in the NIST guide for risk assessments, and included interviews; reviews of documents, policies, and procedures; physical inspections; and automated vulnerability scans.

The review identified 24 principal risks, spread through the low, medium, and high risk ranges. It also detected a large number of technical vulnerabilities, nearly 70% rated high risk or critical, attributed primarily to a lack of updates and upgrades to network servers. The report concluded that for the system as a whole the overall level of risk was high.

The contractor identified significant deficiencies and made recommendations for improvement in the following six areas:

- Vulnerability and patch management process;
- Security training;
- Security documentation and processes;
- Security controls planning;
- Risk management process, including change controls and vulnerability remediation tracking; and
- Fire detection and suppression.

The report included specific recommendations for countermeasures and additional security controls needed to meet best practice policies and to effectively manage the identified risks.

LSC management concurred with the findings and recommendations of the contractor. Management immediately initiated corrective actions and provided a plan of action and anticipated dates of correction for all recommendations.

FY 2013 Corporate Audit

The FY 2013 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 and subject to general oversight by the OIG. The OIG reviewed the work of the firm and found it in compliance with generally accepted government auditing standards.

The *Independent Auditors' Report* stated that LSC's financial statements "present fairly, in all material respects, the financial position of LSC as of September 30, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended ...." The auditors' *Report on Internal Control over Financial Reporting and on Compliance and Other Matters* identified no material weaknesses in internal controls and no reportable noncompliance with laws and regulations.

The audit report did include a management letter prepared by the auditors that identified an opportunity for strengthening LSC's internal controls and operating efficiency by improving LSC's process for preparing complete and accurate footnote disclosures. Management agreed to consider the auditors' recommendations.

Statistical Summary

Audit Reports

Open at beginning of reporting period 9

Issued during reporting period...3

Closed during reporting period 1

Open at end of reporting period..11

Recommendations to LSC Grantees

Pending at beginning of reporting period...............................59

Issued during reporting period...8

Closed during reporting period 9

Pending at end of reporting period 58

Recommendations to LSC Management

Pending at beginning of reporting period.................................0

Issued during reporting period...24

Closed during reporting period 11

Pending at end of reporting period 13

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 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 completed the third year of our Quality Control Review (QCR) initiative, a comprehensive program under which 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.

Third Year Results

During this cycle a total of 35 QCRs were conducted, with the following results:

- Four met standards, with no deficiencies;
- 31 met standards, with one or more exceptions.

Of the 31 meeting standards, but with exceptions:

- o Five did not require additional documentation, but the IPAs need to ensure additional steps are taken in their future audits;
- o Fifteen required the IPAs to provide the OIG with additional documentation to support their conclusions; and
- o Eleven are under review by the OIG.

Seventeen QCRs were issued during the current reporting period, with the following results:

- One met standards, with no deficiencies;
- Four met standards, but with exceptions; additional documentation was not required, but the IPAs need to ensure additional steps are taken in their future audits; and
- Twelve required the IPAs to provide the OIG with additional documentation to support their conclusions.

The OIG received and reviewed additional documentation provided by the IPAs for four of the 12 QCRs issued during the current period. For the remaining eight, we will review additional documentation during the next reporting period.

For those QCRs classified as "meeting standards but with exceptions," the most commonly identified exceptions related to deficiencies in ensuring that LSC grantees complied with all of the requirements in their LSC grants.

During the last reporting period, three QCRs of the FY2012 financial statement audits identified deficiencies for which IPAs were required to provide the OIG additional documentation supporting the work performed or to perform additional audit work. This reporting period, we evaluated the documentation and additional audit work submitted by all three of the IPAs and determined that the deficiencies identified had been corrected.

Also during a previous period, one QCR had found deficiencies in an IPA's work so substantial as to lead to the OIG's initiation of a debarment action. As discussed more fully later in this report (Other OIG Activities – Regulatory Activities), those proceedings were concluded during the current period and resulted in debarment of the IPA for a period of three years.

<u>Advisory Memorandum</u>

In addition to the individual QCR reports, the OIG issued an advisory memorandum for all IPAs and grantee executive directors. The purpose of the memorandum was to inform them of 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 grantees' annual audits.

The memorandum, with a complete list of the specific deficiencies identified, can be found at our website (www.oig.lsc.gov) under the headings, "Auditors" / "Auditors' Resource."

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 so advises 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.

During the reporting period, the OIG reviewed 21 IPA audits of grantees with fiscal year ending dates from June 30, 2013 through September 30, 2013. The audit reports and the findings reflect the work of the IPAs, not the OIG. These audit reports contained four findings. The OIG reviewed the findings and determined that the four findings were either not significant or that corrective action had already been completed, and closed the findings. Therefore, no findings in the IPA reports reviewed during this reporting period were referred to LSC management for follow-up.

INVESTIGATIONS

OIG investigations this reporting period resulted in a pre-trial diversion in lieu of prosecution; two personnel actions; and an LSC management decision requiring a grantee to repay more than $21,400 to LSC. The OIG opened 12 investigations during this period. These included seven criminal investigations, three compliance investigations, and two joint Fraud and 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 time and attendance abuse.

The OIG closed eight investigations during the reporting period. These included five criminal investigations, one compliance matter, one Fraud Vulnerability Assessment, and one joint Fraud and Regulatory Vulnerability Assessment.

Criminal Proceedings

Former Grantee Employee Agrees to Pre-Trial Diversion for Theft of Client Funds

A former employee of an LSC grantee entered into an agreement with state prosecutors for a pre-trial diversion as a result of a scheme to defraud the grantee of $1,651.24. The employee, a secretary, was responsible for receiving client funds and depositing those funds into the grantee's client trust account. On two separate occasions the defendant failed to deposit client funds into the trust account and instead deposited the funds into her personal account. As part of the pre-trial diversion the defendant agreed to supervised probation for no less than nine months, to complete 50 hours of community service, and to make full restitution.

Personnel Actions

Resignation in Lieu of Termination

A fiscal officer at an LSC-funded program resigned from her job in lieu of termination during the pendency of an OIG investigation into questionable travel and payroll claims. At the time of her resignation the program's board of directors was considering her termination from employment based on findings from the OIG investigation. The matter has been referred to the cognizant U.S. Attorney's Office.

Termination of Petty Cash Custodian’s Employment

In October 2013, a grantee reported to the OIG that it had suffered a burglary and theft from its petty cash fund. Investigation by the OIG, including witness interviews and review of the grantee’s security system, determined that a break-in did not occur and confirmed the grantee’s suspicion that the petty cash custodian was the perpetrator. The grantee thereafter terminated the petty cash custodian’s employment.

Recovery Actions

OIG Investigation Results in LSC Recovery of Over $21,400

An OIG investigation, initially reported in our April 30, 2012, semiannual report, found evidence that two LSC grantee attorneys had been conducting unauthorized outside law practices for several years, in violation of LSC regulations (45 C.F.R. Part 1604). Both attorneys, who no longer work at the program, were found to have received compensation for their outside work and to have worked on the matters during their designated work hours at the grantee. The OIG findings were referred to LSC management and a Notice of Questioned Costs was issued questioning the expenditure of $21,424.35 in LSC funds for time spent by the two attorneys while conducting their outside practices. After considering the grantee’s response, LSC management determined the costs should be disallowed. Upon appeal by the grantee, on October 29, 2013, the LSC president affirmed the decision to disallow the costs and advised that the funds would be deducted from the grantee’s remaining payments for the 2013 calendar year.

OIG Receives Award for Outstanding Accomplishment

On October 15, 2013, four members of the OIG investigations unit received an Investigation Award for Excellence from the Council of the Inspectors General on Integrity and Efficiency (CIGIE). CIGIE awards are given annually in recognition of outstanding accomplishments throughout the federal inspector general community. The employees were recognized for developing and piloting the OIG’s Regulatory Vulnerability Assessment (RVA) program. The RVA program was initiated to reduce grantee fraud by examining compliance with grant regulations and guidelines. The program was created in response to fraud investigations that revealed many frauds could have been detected sooner or prevented had the grantee complied with LSC regulatory requirements.

Proactive 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, Fraud Vulnerability Assessments, and Regulatory Vulnerability Assessments, and provide fraud alerts and other information that we believe will help increase grantees' awareness of potential vulnerabilities. This period we continued to implement our recently enhanced program of Fraud Awareness Briefings.

Fraud Awareness Briefings

Fraud Awareness Briefings (FABs) are presented by experienced and knowledgeable OIG investigative staff and cover topics such as who commits fraud, what conditions create an environment conducive to fraud, why people commit fraud, how fraud can be prevented or 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, we have found that program staff members often think that if there is such wrongdoing, it must be minimal. Fraud Awareness Briefings 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.

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, outside auditors, and other interested parties.

Since initiating the FAB program in 2009 we have conducted 94 briefings for grantees in 39 states and one territory, as well as briefings for the LSC board of directors, LSC headquarters personnel, a presentation at the National Legal Aid & Defender Association annual conference, and two webinars that reached multiple grantees.

The enhanced FAB program, which we introduced in 2013, consists of day-long visits to LSC grantees that include not only an all-staff Fraud Awareness Briefing but also in-depth fraud prevention and fraud detection sessions with the executive director, principal financial officer and financial staff, outside auditor, and one or more members of the grantee's board of directors, typically including the chair of the audit committee. During these enhanced FABs, attendees are provided with a guide developed by the OIG that describes LSC grantee-specific fraud indicators. OIG investigative staff members also meet with one or more grantee board members to discuss the board's role in preventing and detecting fraud, including the board's responsibility to supervise the executive director.

During this reporting period the OIG conducted 17 enhanced FABs for LSC-funded programs in California (two), Illinois, Louisiana (two), Mississippi, Missouri (two), Nevada, New Jersey (two), North Carolina, Pennsylvania (two), Tennessee (two) and the U.S. Virgin Islands.

Fraud Vulnerability Assessments

The OIG's Fraud Vulnerability Assessments (FVAs) are conducted on-site at LSC grantee offices and consist of focused document reviews in areas considered high risk, weak, or prone to abuse, along with 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 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 selected other areas that have been linked to the commission of fraud at LSC grantee programs. FVAs can help grantees identify both existing vulnerabilities and potential problem areas. FVAs sometimes detect ongoing fraud or abuse and result in further investigation. FVAs also serve as a deterrent by helping make grantee staff members aware of the potential for fraud and reminding them that the OIG will investigate and seek to prosecute cases involving fraud or the misuse of LSC grant funds. One FVA was completed during this reporting period in Pennsylvania.

Regulatory Vulnerability Assessments

The OIG's regulatory vulnerability assessments (RVAs) are conducted on-site at LSC grantee offices. This initiative was triggered by our experience in recent years in investigating numerous 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 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 on certain key areas, in addition to identifying potential problems from a regulatory compliance point of view, grantees are also able to benefit by applying the classic "ounce of prevention" to areas where there may be broader potential financial vulnerabilities as well.

We completed one joint Fraud and Regulatory Vulnerability Assessment this period, in Louisiana.

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 50 Hotline contacts (compared to 62 for the previous period). Of these matters, 16 were referred to LSC management for follow-up; five were opened as investigations; one is open pending further inquiry; and the remaining 28 were closed.

Statistical Summary

Investigative Cases

Open at the beginning of period 14

Opened during period 12

Closed during period 8

Open at the end of period... 18

Prosecutorial Activities

Referred to prosecutive authority 1

Pre-trial diversion 1

Investigative Activities

Inspector General subpoenas issued..................................... 9

Monetary Results

LSC decision to disallow costs............................... $21,424.35

Restitution per pre-trial diversion agreement $1,651.24

Personnel Actions

Termination of employment... 1

Resignation in lieu of termination 1

OTHER OIG ACTIVITIES

Risk Management Program Review

At the request of the LSC Board of Directors' Audit Committee, the OIG had previously provided detailed comments on updating the LSC risk management program. Generally, the OIG recognized recent efforts made by management in this area and also encouraged "a greater emphasis on a strong and dynamic internal control framework." The OIG advised that LSC should use applicable risk management guides and practices throughout the design and implementation of its risk management program. In particular, we recommended two guides published by the Committee of Sponsoring Organizations of the Treadway Commission[1] (COSO), "Internal Control – Integrated Framework" and "Enterprise Risk Management – Integrated Framework."

The OIG identified six essential elements for success for LSC's risk management: further alignment with its strategic plan; the need for a dynamic process; the importance of a strong tone at the top; the development of performance and risk measures; communication and coordination; and risk management training across the organization. We also recommended further clarification of LSC's risks and their rankings, and identified additional risk areas, including: management systems; LSC regulations; grant competition; sub-grant oversight and performance; information technology investments; and security.

During this reporting period, LSC included four of the OIG-recommended risk areas in its risk management matrix. These recommendations pertained to risks associated with management systems, also identified by the Government Accountability Office (GAO) in its *2013 High Risk List of Federal Programs,* including:

- Performance management risks, such as the potential failure to achieve performance goals if annual performance cycles are not established.
- Human capital management risks, such as the potential failure to attract, retain, and motivate staff with skill sets that allow the organization to meet its strategic goals.
- Information management risks, such as the potential failure to collect and share vital grantee oversight information if central information management systems and a more transparent culture are not established.

[1] The National Commission on Fraudulent Financial Reporting (usually referred to as the "Treadway Commission," for its first chairman, former SEC Commissioner James C. Treadway, Jr.), was a private-sector initiative established in the mid-1980's and jointly sponsored and funded by five professional accounting organizations: the American Institute of Certified Public Accountants (AICPA), the American Accounting Association (AAA), the Financial Executives International (FEI), the Institute of Internal Auditors (IIA), and the National Association of Accountants (NAA). The five organizations formed the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as a joint initiative dedicated to the development of frameworks and guidance on enterprise risk management, internal control, and fraud deterrence.

- Acquisitions management risks, such as weaknesses in policies and procedures leading to potential higher contract costs and vulnerabilities to fraud, waste, and abuse.

LSC Procurement Policies and Procedures

During this reporting period, the OIG issued a memorandum on *Suggested Revisions to the LSC Procurement and Contracting Policies and Procedures.* This memorandum was developed in response to a request by LSC management for OIG input as LSC was embarking on a revision of its procurement and contracting policies and procedures.

Overall, the OIG noted that LSC "should strive to achieve a smarter, stronger, more streamlined, fair and competitive acquisition process to achieve best value for the Corporation." The OIG provided recommendations in 19 acquisition areas including: acquisition goals; procurement and contracting standards; organizational roles and responsibilities; controls; procurement and contracting records; electronic business processes; procurement planning; sole-source exceptions; socio-economic policies; standards of conduct and ethics; purchase orders and invoices; past-performance records; procurement cycle; procurement thresholds; solicitation; information technology procurements; source selection and evaluation; contracts; and other resources and guidance.

The OIG recommended that LSC, in reviewing its procurement policies and procedures, should consider the provisions of the Federal Acquisition Regulation (FAR) as well as the practices of other non-profit organizations. We emphasized that acquisition roles and responsibilities be formalized and clarified, and that the procurement processes be further coordinated and more centrally managed. We encouraged better procurement planning to avoid excessive sole-sourcing, facilitate fair and open competition, and obtain 'best value' for the Corporation. We also stressed that proper management controls should be implemented and that all contractual procedures be adequately documented. We noted that LSC should consider modernizing and integrating e-business into its procurement and contracting procedures. We also identified areas for improvements in the solicitation and evaluation processes and recommended more detailed guidance on contract management and financial procedures.

In its ongoing strategic planning process, the OIG has identified acquisition management as one of LSC's major management challenges. This memorandum followed several meetings with management as well as other OIG efforts related to acquisition management, including recent and ongoing audits of LSC's consultant contracts, a 2013 contracting review, and procurement training recommendations.

LSC management has received the OIG's recommendations positively.

Management Information Memoranda

The OIG issues Management Information Memoranda (MIMs) when we believe that issues uncovered in the course of ongoing work should be brought promptly to management's attention, so that management may consider taking immediate corrective action. During this reporting period, the OIG issued a MIM entitled, *Grantees' Personnel Compensation Data Collection*. This memorandum recommended that management collect and analyze more comprehensive compensation data for grantees' key employees in order to improve fiscal oversight and the effective and efficient use of grants funds. The MIM also provided possible additional compensation data collection areas for management's consideration. This recommendation was based on recent OIG work, including a 2012 audit, *Report on Selected Internal Controls, Inland Counties Legal Services, Inc.*, two investigations, and an OIG compensation data analysis.

Regulatory Activities

IPA Debarment

During this reporting period the OIG issued a final decision under the provisions of 45 CFR Part 1641, debarring an independent public accountant (IPA) for a period of three years. Based on the findings of a Quality Control Review issued in a previous period, the OIG had rejected the subject audit report and issued a notice of proposed debarment. The IPA was invited to provide a response (which was submitted during the last reporting period); the affected grantee also provided comments. The OIG's debarring official also engaged another outside audit firm to perform independent fact-finding. The debarring official concluded that the IPA's work evidenced multiple violations of government auditing standards and OIG guidance, and debarred the IPA (and his firm) from auditing LSC recipients for three years. The IPA appealed and, after thoroughly considering the IPA's arguments against debarment, the Inspector General upheld the debarment decision.

Rulemaking

The OIG responded to LSC management's request for comments concerning LSC's private attorney involvement (PAI) rule. While not opposing changes to the rule, our comments urged a deliberative approach to rulemaking that would weigh proposals and comments in light of the underlying purpose of the rule as a whole. We commented that, with limited resources directed towards the PAI program, a revised rule that expanded participation of non-attorneys might have the unintended consequence of reducing the funding available for the involvement of private attorneys. We also recommended that any revisions of the existing PAI rule be calculated to maintain the rule's focus on direct legal services provided to the client population in preference to ancillary services provided by private attorneys and other private-sector professionals. In addition, we recommended the inclusion of mechanisms to track any expanded PAI program that would involve non-attorneys, and suggested the rule be crafted in a manner so as to encourage compliance.

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, we received eight FOIA requests and one FOIA appeal. All requests for which responses were due within the reporting period 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 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 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 Office of Inspector General for the Corporation for Public Broadcasting, and was completed 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) – The OIG did not conduct a peer review of another Office of Inspector General during this reporting period. There are no outstanding recommendations made from any previous peer review that remain outstanding or have not been fully implemented.

TABLE I

Audit Reports and Quality Control Reviews Issued for the Period Ending March 31, 2014

Audit Reports

Report Title	Date Issued	Questioned Costs	Funds Put To Better Use	Unsupported Costs
Legal Services Corporation FY 2013 Financial Statement Audit Report	1/08/14	$0	$0	$0
Report on Selected Internal Controls – Land of Lincoln Legal Aid Foundation	3/24/14	$0	$0	$0
Report on Selected Internal Controls – Appalachian Research and Defense Fund	3/26/14	$0	$0	$0

Quality Control Reviews

	IPA	Recipient	Date Issued
1	Coleman and Williams, Ltd.	Legal Action of Wisconsin	10/16/13
2	Satty, Levine & Caico, CPAs	Nassau/Suffolk Law Services Committee	10/16/13
3	Gomez, Fragoso and Associates	Texas RioGrande Legal Aid	10/16/13
4	Wisan, Smith, Racker & Prescott	Nevada Legal Services, Inc.	12/19/13
5	Roy & Rurak	Merrimack Valley Legal Services, Inc.	12/19/13
6	Cropper Accountancy Corporation	Legal Services of Northern California	1/06/14
7	Schneider, Larche, Haapala & Co.	Legal Services of Northern Michigan	1/06/14
8	Gary McGee & Co.	Legal Aid Services of Oregon	1/06/14
9	Harrington Langer and Associates	Central Minnesota Legal Services	1/06/14
10	Brady, Martz and Associates	Legal Services of North Dakota	1/09/14
11	Kraft CPAs	Legal Aid Society of Middle Tennessee	2/19/14
12	David L. Gruber & Associates	Legal Aid Society of Orange County	2/24/14
13	Aarons Grant & Habif	Atlanta Legal Aid Society	2/24/14
14	Berberich Trahan & Co.	Kansas Legal Services	3/10/14
15	David G. Faw, CPA	Legal Services Corp of Delaware	3/11/14
16	Clifton Larson Allen	Florida Rural Legal Services	3/11/14
17	Alexander Aronson Finning CPAs	South Coastal Counties Legal Services	3/18/14

TABLE II

Audit Reports Issued with Questioned Costs for the Period Ending March 31, 2014

	Number of Reports	Questioned Costs	Unsupported Costs
A. For which no management decision has been made by the commencement of the reporting period.	5	$1,606,081	$223,312
B. Reports issued during the reporting period	0	—	—
Subtotals (A + B)	5	$1,606,081	$223,312
C. For which a management decision was made during the reporting period:	3	$220,119	$218,673
(i) dollar value of recommendations that were agreed to by management		$4,931	$4,023
(ii) dollar value of recommendations that were not agreed to by management		$215,188	$214,650
D. For which no management decision had been made by the end of the reporting period	2	$1,385,962	$4,639
Reports for which no management decision had been made within six months of issuance	2	$1,385,962	$4,639

TABLE III

Audit Reports Issued with Funds to Be Put to Better Use for the Period Ending March 31, 2014

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

TABLE 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

Report Title	Date Issued	Questioned Costs	Comments
Report on Selected Internal Controls – Inland Counties Legal Services	8/06/12	$1,367,480	Notice of questioned costs issued. Management decision provided to grantee on January 29, 2014. After requesting an extension of time, the grantee appealed to the LSC president on March 13, 2014.
Report on Selected Internal Controls – Lone Star Legal Aid	1/15/13	$18,482	Notice of questioned costs issued on February 19, 2014. On March 20, 2014, grantee received a two-week extension of time to respond.

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

Report Title	Date Issued	Comments
Report on Selected Internal Controls – Legal Services of Northern Virginia, Inc.	9/30/11	LSC management is working with grantee to resolve all open recommendations.
Report on Selected Internal Controls – North Mississippi Rural Legal Services	3/30/12	Corrective action in progress.
Report on Selected Internal Controls – Texas RioGrande Legal Aid, Inc.	6/12/12	Corrective action in progress.
Report on Selected Internal Controls – Inland Counties Legal Services, Inc.	8/06/12	Corrective action in progress. Two recommendations closed this period.
Report on Selected Internal Controls – Lone Star Legal Aid	1/15/13	Corrective action in progress.
Report on Selected Internal Controls – Community Legal Services	3/21/13	Corrective action in process.
Report on Selected Internal Controls – Indiana Legal Services	9/30/13	Corrective action in process
Report on Selected Internal Controls – Central Virginia Legal Aid Society	9/30/13	Corrective action in process

TABLE V
Index to Reporting Requirements
of the Inspector General Act

IG Act Reference*	Reporting Requirement	Page
Section 4(a)(2)	Review of legislation and regulations.	20
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.	12, 17
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.	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.	22

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

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