



July 27, 2009

The Honorable Charles E. Grassley
Ranking Member, Committee on Finance
United States Senate
135 Hart Senate Office Building
Washington, DC 20510

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Dear Senator Grassley:

It has come to our attention that you have raised several questions about the activities of the Legal Services Corporation (LSC) in a July 17, 2009 letter sent by your office to the leadership of the Senate Appropriations Committee and the Subcommittee that oversees our annual funding.

The Corporation appreciates the review by the Government Accountability Office (GAO) and LSC's Office of Inspector General (OIG), and the opportunity it presents to make improvements in our operations. We have followed-up responsibly and implemented all recommendations made by GAO. With respect to the contracting recommendations made by the OIG, we expect to implement them all by October 1, 2009.

Enclosed is our response.

Respectfully yours,

Victor M. Fortuno
Vice President and General Counsel

Legal Services Corporation Response to July 17, 2009 Letter by Senator Charles E. Grassley

The following lists the Senator's concerns, in italic, followed by the Corporation's response.

... I continue to receive complaints from whistleblowers regarding the operation of LSC headquarters. The complaints include, but are not limited to, allegations that LSC and its President:

1. Failed to notify the Board about its 2009 deficit spending; and

Response: There has been no deficit spending by LSC in FY 2009 and there will be none. In anticipation of a FY 2009 budget shortfall, LSC Management recommended to the LSC Board in July 2008 that LSC initiate either a reduction in force beginning in October 2009 or a reprogramming of FY 2008 funds to cover the shortfall, which partially resulted from five years of flat funding in the MGO account. The Board chose to reprogram funds, which congressional appropriators approved in September 2008 with the stipulation that the reprogrammed funds be repaid once the FY 2009 Appropriations bill passed. The only controversy revolved around whether Management gave the Board enough advance notice of the pending shortfall in 2008.

2. Altering, revising, and modifying legal opinions prepared by, among others, LSC's Office of Legal Counsel.

Response: The Corporation's Executive Team does review and interact with counsel, including the Corporation's in-house counsel, on legal opinions. However, this is not a new or novel practice and, given that those opinions relate to programs and oversight, it makes perfectly good sense to approach them in this collaborative manner. The discussions help to focus the analysis and the resulting product is improved by interaction with the programmatic side of the Corporation. Counsel is not only free to reject the feedback of the Executive Team but expected to exercise independent judgment and offer his/her best advice on legal issues.

3. Next, I continue to be troubled by GAO's findings and the LSC OIG's most recent Semiannual Report to Congress, as well as the audits more recently conducted by LSC's OIG. More specifically, I am concerned that many of the recommendations suggested by both the GAO and by the LSC OIG remain outstanding.

Response: With respect to the GAO's findings in August 2007 on LSC's governance and accountability practices and in December 2007 on LSC's grants management and oversight reports, LSC has agreed with and implemented all of the recommendations over the past two years. In August 2008, LSC provided a detailed accounting to the GAO of all the steps the Corporation took in implementing all the recommendations and testified to the same in September 2008 before a Senate Judiciary Committee hearing. Currently, the GAO is conducting a follow-up on-site visit at LSC to close out the recommendations of both reports.

With respect to the OIG's latest semiannual report to Congress, below are the six open audits, including one recommendation to LSC management.

Legal Services NYC

Grantee has notified OCE that funds in question have been credited to the LSC fund using non-LSC funds, and the OIG has been notified. Audit recommendation will close pending receipt of an amended accounting manual from grantee. OIG notified on May 27, 2009 that grantee will complete their manual by end of calendar year.

Legal Aid and Defender Association, Inc.

LSC has sent questioned cost notice to grantee and informed them of a full onsite review of IT contract to commence on September 21.

California Indian Legal Services

LSC has sent questioned cost notice to grantee with a July 29 due date for response.

Legal Assistance Foundation of Metropolitan Chicago

Grantee has informed OCE of full reallocation of funds in question and OIG has been notified. OIG analysis complete on grantee corrective action plan. Audit recommendation closed as of July 23.

Philadelphia Legal Assistance Center

Revised audit guide for grantee has been submitted, reviewed by OCE, and provided to OIG for review. Audit recommendation closed as of July 23.

Legal Services Corporation Fiscal Year 2008 Financial Statement Audit Report

The one recommendation to LSC Management pending at end of reporting period is Legal Services Corporation Fiscal Year 2008 Financial Statement Audit Report Finding 08-1. Classification of certain workers as independent contractors. In response to the FY 2008 audit of LSC finances, LSC obtained outside counsel to review whether LSC's independent consultants have been properly classified and will implement their advice by October 1, 2009. LSC has relied on independent consultants to assist with program visits for more than 20 years.

4. Consulting Contracts. Just a few weeks ago the LSC OIG completed an audit of LSC's Consultant Contracts. The LSC OIG in its Executive Summary stated that LSC needs to strengthen internal controls over consultant contract actions by documenting contracting decisions, evaluating contract alternatives, and establishing procedures to monitor contractor compliance with contract provisions;

Response: LSC is revising its budget process to better document its annual evaluations of the most cost-effective combination of staff and consultants to conduct program visits, and those revisions will be in place by September 1, 2009. LSC is also revising its Administrative Manual to better document contract decisions and require more documentation of contractor compliance, and those revisions will be in place by October 1, 2009.

4a. may have entered into independent contractor agreements with individuals who should have been classified as employees under IRS rules. As a result, LSC could be liable for fines, penalties, and additional payments to workers; and

Response: This is the same issue described in the LSC financial audit referenced above.

4b. did not comply with its policies and procedures over the consultant contracting process. Specifically, competition requirements were not followed, required approvals were not obtained, required basic information was not used in some contracts, forms to control the contracting process were not used, purchase orders were not always prepared, and contracting records were not properly maintained.

Response: LSC is adding provisions to its Administrative Manual to specify the appropriate requirements for soliciting, approving, and maintaining records of such contracts. The revisions to the Administrative Manual will be in place by October 1, 2009. A standard contract, with fixed fees, was used, setting daily rates for consultants generally at \$400 per day with total billings per contract of less than \$5,000. Consultants were selected based on demonstrated proficiency in evaluating the performance of grantees.

4c. Additionally, the LSC OIG determined that contrary to LSC policy, LSC bypassed the competitive bidding process and awarded consultants "Sole Source" contracts, without documentation substantiating the need for sole source contracting. In addition, the LSC OIG determined that LSC failed to follow its own policies in 37 of the 38 contracts reviewed;

Response: The OIG recommended changes to improve LSC contracting practices, and the Administrative Manual will be revised by October 1, 2009 to incorporate those recommendations.

4d. Standard contract language was changed in at least two contracts allowing "double dipping" on the part of individuals who worked for both an LSC funded program and for LSC headquarters.

Response: No individuals "double dipped," i.e., were allowed to be paid from two LSC sources for the same period of time. The two contracts where language prohibiting double dipping was omitted by mistake did not result in any such payments.

5. Capitol Hill Reception. In January 2008 the LSC Board sponsored a reception in the Lyndon Baines Johnson Room of the United States Capitol Building. The event was held to honor two longstanding Senate supporters and to provide an opportunity for LSC staff to meet congressional staff, Members of Congress, and members of the DC Bar. One hundred and fifty-one invitations were present and the invitations indicated specifically that "no federal funds are being used for this event." (emphasis added) The event cost about \$5,000, which, included: \$980.00 in alcohol, bus transportation, food and drinks, awards, and photography. Aside from the cost of the event, what I find troublesome is that LSC Management represented to, among others, Members of Congress that it would not use any taxpayer funds to pay for the event. However, LSC federal funds were inappropriately used, according to the LSC OIG.

Response: The OIG investigated the 2008 Capitol Hill reception and determined that while it had been the intention of LSC management from the outset to fund the event with private dollars, the LSC credit card had been used to advance the funds to pay for the event when adequate private support was delayed. All advanced funds were eventually reimbursed, with interest, using private donations. The Audit Committee of the LSC Board of Directors also reviewed the matter, drew the same conclusions as the IG, and drafted a "Protocol for the Acceptance and Use of Private Contributions to LSC," which among other things prohibits the advancing of federal

funds. The protocol was presented at the August 2008 meeting of the Board and unanimously adopted.

6. The LSC OIG also determined in 2009 that LSC violated the Government in the Sunshine Act (Act) when the Board deliberated and acted upon the renewal of LSC President Barnett's employment contract in a closed session without publishing advance notice. That Act was passed and signed into law to promote transparency and accountability within the federal government. On November 1, 2008 the Board renewed LSC's President Barnett's contract in a closed session. The OIG determined that this action was in violation of Section 4.04(a) of LSC's bylaws. (Attachment 3, LSC OIG response letter to Senator Grassley, 2/27/09, pages 1-4).

Response: On November 1, 2008, the Board renewed the LSC President's contract in a closed session meeting and the OIG thereafter issued a March 17, 2009 memorandum to the Board in which it concluded that "LSC **may** have violated . . . the Sunshine Act" by holding the Board's discussion of renewal of the President's contract in closed session without publishing advanced notice. (Emphasis added.)

The President's performance evaluation was publicly and timely announced and published in advance of the meeting. Consideration of renewal of the President's contract logically flows from consideration and action on her performance evaluation, which was expressly noticed in the published meeting announcement. Therefore, it is not at all clear that there was even a technical violation of the advance public notice requirement in either the Sunshine Act or LSC's own bylaws. Nevertheless, recognizing in hindsight that explicitly listing the two – performance evaluation and contract renewal – separately would have more clearly put the public on notice that renewal of the President's contract would be considered along with evaluation of her performance, the Board will ensure that all future public notices of its meetings are as clear as possible.

7. GAO. In December 2007, the GAO reported that after 1994, the division of LSC now known as the Office of Compliance & Enforcement (OCE) discontinued its practice of reviewing the financial statement-related audits and its internal control reviews of LSC's grantees. Additionally, the GAO determined that LSC reduced dramatically the number of staff reviewing the financial statements from 12 to 2. GAO articulated that this was done despite the fact that oversight of a grantee's financial controls is a basic management responsibility.

Response: Financial review of grantees is a shared responsibility between the OIG and OCE. Following the reorganization of LSC's grants monitoring unit in 1994, the oversight of grantees' annual audits was transferred to the OIG in May of 1995. However, LSC management continued to review audited financial statements to ensure grantee compliance with LSC laws and regulations. The transfer of audit oversight was specifically authorized by the FY 1996 Appropriations Act language which has been carried forward each year since. With the FY 2009 increase in funding for Management and Grants Oversight (MGO), LSC is increasing its OCE financial oversight staff from 3 positions to 6 positions in order to provide more oversight of grantee's financial operations.

7a. The GAO also reported that "LSC's internal controls over grants management and oversight of grantees that negatively affect LSC's ability to provide assurance that grant funds are being used for their intended purposes in compliance with applicable laws and regulations."

Response LSC agreed with and implemented all of GAO's recommendations in its December 2007 report on LSC's grants management and oversight practices. For the past two years, LSC has worked diligently to improve and tighten the Corporation's operations, including its internal controls and grants oversight procedures. In response to GAO's recommendation that the LSC Board of Directors develop and implement policies that clearly delineate organizational roles and responsibilities for grantee oversight and monitoring, the LSC Board of Directors created an Ad Hoc Committee to work with LSC management and OIG. The recommendations of the Ad Hoc Committee were adopted by the Board of Directors in a resolution on April 26, 2008 setting out the responsibilities of LSC's oversight offices. Additionally, LSC issued expanded guidelines for the Office of Program Performance and the Office of Compliance and Enforcement, two of the Corporation's oversight offices, that included a full review of the procedures for on-site program assessments. Other actions taken by LSC include:

- Strengthened the financial accountability procedures by revising and expanding guidelines for financial reviews designed to address issues raised by the GAO.
- Expanded information sharing and coordination among LSC's oversight offices, including periodic training for oversight staff.
- Enhanced the risk assessment criteria for selection of grantees for program visits and updated all internal operating procedures.
- Implemented a risk-management system.

7b. To support its findings the GAO documented one LSC grantee that was using LSC funds to supply interest-free loans to employees. The loans were used for, but not limited to, college tuition, computers and down payments on personal residences. It is interesting to note that the employees were not required to sign a contract, and when asked by GAO to supply the documentation to support the loans, the grantee was unable to comply.

Response: While salary advances are permissible, as they are in many corporations, LSC grantees need to have written policies on their use. On March 20, 2008, LSC sent an advisory to all grantees which, among other issues, addressed the need for written policies governing salary advances.

7c. GAO reported further that "LSC grantee reviews missed potential control deficiencies at grantees that could have been detected with more effective oversight as evidenced by weaknesses GAO found at 9 of the 14 grantee sites it visited. While control deficiencies at the grantees were the immediate cause of the problems GAO found, weaknesses in LSC's controls over its oversight of grantees did not assure effective monitoring of grantee controls and compliance. Among the questionable expenditures GAO found were grantee use of funds for expenditures with insufficient supporting documentation, unusual contractor arrangements, alcohol purchases, employee interest-free loans, lobbying fees, late fees, and earnest money."

Response: On November 20, 2007, LSC referred eight of nine programs identified by the GAO to the OIG for follow-up. The OIG has completed field work at all eight programs and found that management at the grantees had adequately addressed the GAO recommendations, and are implementing additional controls to prevent those issues from recurring. Only two programs required follow-up action by LSC, which is currently underway.

As stated above, in March 2008, LSC sent an advisory to all grantees which addressed the need for appropriate documentation of expenditures of LSC funds, the regulations regarding unallowable costs, and specifically stressing the prohibition of expenditures for alcohol and lobbying, the need for written policies governing salary advances, and a reminder of the regulation governing derivative income.

8. Legal Aid Defender Association of Detroit (LADA). The LSC OIG conducted a review of LADA after the GAO's review to examine whether or not LADA had implemented GAO's recommendations. The LSC OIG determined that issues raised earlier in the GAO's report still existed at the LADA. I suspect that this is in part the case because LSC is not conducting vigorous oversight of its grants as GAO determined earlier.

Response: The Detroit grantee (LADA) was one of the programs LSC referred to the OIG in November 2007. The OIG issued its report on the grantee in February 2009. LSC did not visit LADA earlier because the OIG was conducting its audit of LADA.

8a. Overall, the LSC OIG determined LSC funds were used for mortgage payments, creating a reversionary interest to LSC which has not properly documented.

Response: As reflected in the OIG report, this matter has been resolved and closed by the OIG and was never referred to LSC management for follow-up.

8b. The intake staff did not inquire about callers' citizenship or alien status during telephone intake screening;

Response: As reflected in the OIG report, this matter has been resolved and closed by the OIG and was never referred to LSC management for follow-up.

8c. Some cost reallocations were not adequately supported;

Response: On July 15, 2009, LSC provided a determination of questioned costs and corrective action requirements to LADA based on a review of all pertinent information, including the OIG's audit report on the program. To date, LSC has questioned a total of \$6,866.54 related to unsupported travel payments, alcohol related disbursements, unsupported cost reallocations and duplicate postings. A response from LADA is due in mid-August.

8d. Allocations of indirect costs were not adjusted at year end for actual charges.

Response: As stated above, LSC is conducting a questioned cost proceeding on this matter.

8e. The LSC OIG also noted that the grantee reimbursed its Information Technology contractor about \$500,000 more than the \$300,000 authorized. The LSC OIG questioned \$267,000. In addition, the LSC OIG questioned over \$3,000 associated with the purchase of alcohol. Currently the issue is before LSC management for review and action.

Response: Regarding the questioned costs related to the information technology overpayment, LSC has determined that additional investigation is necessary. Accordingly, an on-site review of these issues is scheduled for September 2009.

9. *California Indian Legal Services (CILS).* In March 2009, the LSC OIG referred a total of about \$80,000 in questioned costs to LSC Management upon completion of the CILS review. Of the \$80,000 in questioned costs, about \$40,000 was related to a CILS conference. CILS management indicated that the conference was to be paid by several different funding sources, including taxpayer funds. However, the LSC OIG determined in its limited review that food, rooms, and conference facilities were paid by LSC grantee funds. Additionally, the LSC grantee paid for 300 room nights, of which only 164 nights were used, unnecessarily costing taxpayers an additional \$6,384.

Response: LSC management referred this matter to the OIG in November 2007 and the OIG issued a report in March 2009. As a result of the OIG's findings and recommendations of its audit fieldwork on CILS, including CILS' management responses, LSC determined there was sufficient basis for disallowing costs of \$80,000 and issued a formal Notice of questioned costs to the program on May 29, 2009. Additionally, LSC requires that CILS implement corrective actions such as maintaining adequate documentation, developing payment voucher controls, ensuring adequate expenditure documentation and procedures and establishing controls to ensure that identifiable direct costs are properly allocated to funding sources. The program has until July 29, 2009 to respond to the questioned cost Notice.

10. *California Rural Legal Assistance (CRLA).* In September 2005, LSC OIG opened an investigation into LSC grantee, CRLA. In furtherance of the investigation the OIG served CRLA with an OIG subpoena request for documents. CRLA refused to comply with the subpoena forcing the LSC OIG to request that the Department of Justice intervene and file a petition to enforce the OIG subpoena in United States District Court. The petition was filed and fully briefed in October 2007, and again in April 2009. Four years have passed and the matter is still before the court awaiting resolution. This example again underscores the lack of oversight and accountability at LSC. And, certainly, Congress needs to be doing better oversight. LSC has continued not only funding CRLA, as is determined below but has increased its yearly appropriations even though there is an ongoing investigation into CRLA. CRLA funding by year: 2009: \$7,948,279; 2008: \$7,222,330; 2007: \$7,186,924; 2006: \$6,700,745.

Response: With respect to CRLA's yearly funding, LSC's basic field grants to all 137 grantees are distributed according to a formula mandated by Congress based on the poverty population in any given service area. CRLA's funding has increased over the past four years due to the annual increases in basic field funds appropriated by the Congress.

Since 2006, the OIG has had an ongoing investigation of CRLA. The OIG is awaiting a court decision in its subpoena enforcement action. As a result of the preliminary determinations by the OIG, LSC placed the program on short-term funding cycles with stringent grant conditions and monthly reporting requirements for two years. CRLA continues on short-term funding. The OIG has requested that LSC management not initiate a full compliance review of CRLA until it completes its investigation, in order not to interfere with the investigation. LSC intends to complete a full compliance review after the OIG's subpoena enforcement action is resolved. As to the delay in the rendering of a decision by the District Court, LSC management has no control over this matter.

11. The LSC OIG and the GAO have demonstrated time and time again through their objective and thorough audits, evaluations, and reports that LSC Headquarters continues to operate in total disregard of federal law when it suits them. The fact that serious and vigorous oversight of the LSC grantee community is almost non-existent is to say the least, alarming.

Response: LSC does not operate in a “total disregard of federal law.” LSC acts in good faith and with full respect for federal law. The Corporation exercises serious and vigorous oversight of grantees compliance with all laws, regulations and expenditures.

12. This misuse of federal funds that has happened over the years is offensive and ranges from the LSC President using a limousine to travel to Capitol Hill from her Georgetown office, to the purchase of \$14.00 cookies.

Response: The OIG investigated LSC’s fiscal practices and issued a report with 11 recommendations in September 2006. The OIG did not find that LSC’s spending practices violated any laws and LSC implemented all the recommendations. Management undertook a comprehensive review to bring LSC’s spending policies in line with federal guidelines when appropriate, reduced costs in the areas of travel, lodging, and meals, revised its administrative manual to include guidance on the use of car services and reduced costs for food in connection with Board meetings.

13. Indeed, just last week it was reported to me that one legal services program used taxpayer money to purchase \$150,000 of natural stone (e.g. granite, marble). I continue to await a response to that allegation along with the relevant on-site review documents.

Response: LSC sent a response to Senator Grassley’s July 14, 2009 letter of inquiry indicating that the OIG conducted an audit of the Legal Aid of NorthWest Texas. The audit will report on the purchase of the “natural stone” for its new office building. The audit was initiated earlier this year. The OIG received a response from NorthWest Texas on July 24, 2009 and is completing its report. LSC will follow up on any OIG recommendations, including any questioned costs.

14. I submit further that in light of the most recent LSC OIG report on contracting, that LSC be required to comply with the Federal Acquisition Regulations in the future.

Response: Congress appropriated \$390 million to the LSC in FY 2009. Of that amount, more than 95 percent is distributed through grants, the vast majority of which is distributed according to a congressionally-mandated formula. The FAR would not apply to this distribution. In addition, most of the remaining annual appropriation is for Management & Grants Oversight, which funds salaries, travel and rent. All are outside the FAR. While the LSC Administrative Manual is based on the same principles as the FAR, LSC’s processes are simpler and do not involve the additional constraints necessary when contracting for large purchases. As indicated in the OIG report on the audit of LSC’s contracting practices, the typical LSC consulting contract is for less than \$5,000. Requiring LSC to comply with the FAR for its relatively small acquisitions budget would require unnecessary administrative overhead. LSC is revising its contracting practices in conformance with all of the OIG recommendations.

LSC Fact Sheet

About Allegations of Wasteful Spending at the Legal Services Corporation (LSC)

Allegations of improper use of taxpayer dollars are referred to the LSC Office of Inspector General and investigated. When the OIG makes recommendations, LSC follows up with corrective action. If federal funds are improperly used, LSC recovers that money and redirects it to provide civil legal assistance to the nation's poor. For example:

Natural Stone Wall: LSC raised concerns about Legal Aid of NorthWest Texas with the Inspector General last year, who initiated an audit in February. LSC awaits a report from the IG. The nonprofit program constructed a new building because its old building was unsafe (substandard mechanical, electrical and plumbing systems) and lacked adequate free parking for the poor. The building was required to meet new Fort Worth Urban Design Standards because it is on a gateway entrance to the downtown, and that led to three years of negotiations with the city. Under the mortgage, the program will save up to \$371,000 per year over the next 10 years, compared to leasing similar space. The project manager also reduced the construction budget by \$100,000. Those savings can be directed to better serving the poor.

Unused Hotel Rooms: In 2007, California Indian Legal Services sponsored a statewide Tribal Court Conference and overestimated attendance. LSC is questioning conference expenditures and will recover the money if the nonprofit program is at fault.

Contracts for Consultants: This is about job classifications for individual consultants who join LSC staff on program visits to check quality and compliance with grant rules. Over the last 20 years, LSC has received contradictory opinions over whether these experts should be classified as consultants or as temporary employees, and the issue was taken up again last year after it was raised by LSC's outside independent auditor. LSC has retained pro bono services of an outside law firm to make a determination on proper job classifications. LSC's grant compliance office advertises for consultants and selects them based on their expertise. They have been paid a standard rate of about \$400 per day, and they work a week at a time, two or three times a year. These are modest expenditures for effective program oversight, a key goal of the Congress.

Double Dipping: The allegation is simply wrong. "Double dipping" is not allowed and has not occurred. Consultants hired from LSC grantees must take unpaid leave from their nonprofit while contracting with LSC—they cannot take vacation or any other form of compensation. The prohibition on double dipping was inadvertently left out of contracts with two individuals but it never occurred.

Other issues: They go back over three years and have been addressed either by LSC management or the IG. Expenditures deemed improper have been repaid.