



Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

3333 K Street, NW, 3rd Floor
Washington, DC 20007-3558
202.295.1660 (p) 202.337.6616 (f)
www.oig.lsc.gov

August 4, 2011

Ms. Devon Lee Lomayesva
Executive Director
California Indian Legal Services
609 S. Escondido Boulevard
Escondido, CA 92025

Dear Ms. Lomayesva:

Enclosed is the Office of Inspector General's final report on the results of our follow-up audit on Selected Internal Controls at California Indian Legal Services.

We have reviewed your response to the recommendation in the draft report and the information subsequently provided that documented your process for allocating costs. The procedures provided adequately address the recommendation. Therefore, Recommendation 1 is considered closed.

Since your program has implemented procedures to ensure that attorney incentive payments are not charged to LSC funds, we are issuing no recommendation at this time. However, the \$27,600 in attorney incentive payments improperly charged to LSC funds in 2008 has been referred as a questioned cost to the LSC Office of Compliance and Enforcement for review and decision.

Thank you and your staff for your courtesy and cooperation during this audit.

Sincerely,


Jeffrey E. Schanz
Inspector General

Enclosure

cc: James Sandman, President
Legal Services Corporation

**LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL**

**FOLLOW-UP REPORT ON SELECTED
INTERNAL CONTROLS**

**CALIFORNIA INDIAN LEGAL SERVICES,
INC.**

RNO 705158

Report No. AU-11-03

August 2011

www.oig.lsc.gov

TABLE OF CONTENTS

INTRODUCTION.....	1
OBJECTIVE	1
SCOPE AND METHODOLOGY	1
OVERALL EVALUATION	2
RESULTS OF AUDIT	2
ALLOCATION SYSTEM DOCUMENTATION.....	2
Recommendation 1.....	3
Grantee Response to Recommendation 1.....	3
ATTORNEY INCENTIVE PAYMENTS	3
OIG Comment.....	4
Grantee Comment	4
OIG EVALUATION OF GRANTEE COMMENTS.....	4
APPENDIX I – GRANTEE COMMENTS	

INTRODUCTION

This report presents the results of a follow-up audit on the OIG's *Report on Selected Internal Controls, California Indian Legal Services (AU09-03)*, March 2009. The purpose of this audit was to determine if management implemented corrective actions to address selected findings contained in the initial report and whether those actions, in fact, corrected the conditions cited.

OBJECTIVE

The overall objective of this audit was to determine whether adequate corrective actions had been taken by California Indian Legal Services' (CILS or grantee) management to correct selected conditions cited in the OIG's initial report. Specifically, the OIG determined whether the grantee's cost allocation system was adequately designed, fully documented, and implemented as designed. In addition, the OIG determined whether attorney incentive payments¹ resulting from CILS' fee for service program were properly allocated.

SCOPE AND METHODOLOGY

To accomplish the objective, the OIG reviewed manuals, guidelines, memoranda, and directives setting forth current grantee practices. To obtain an understanding of the allocation process, grantee officials were interviewed as to their knowledge and understanding of the processes in place. In addition, grantee officials provided a detailed demonstration of the processes implemented and the source of the data used in the system. The OIG also interviewed LSC Headquarters staff to obtain an understanding of LSC policies and practices for addressing deficits in recipient's LSC fund balance. Computer generated data provided by the grantee was relied on to obtain an understanding of the allocation system. However, the OIG did not conduct tests of the general or application controls over the computer system.

To determine if attorney incentive payments were properly allocated for calendar years 2008 and 2009, source documents for all such payments were reviewed. A total of seven attorney incentive payments valued at over \$89,000 were made during the period under review.

The audit field work was conducted at CILS' main office in Escondido, California and at LSC Headquarters in Washington, DC, from January, 2010 through October, 2010. An onsite visit to CILS was conducted in January 2010. Documents and information reviewed at CILS pertained to the period January 1, 2006 through January 12, 2010.

¹ CILS operates a billable hours program funded with Tribal funds. The attorney incentive payments result from the work that attorneys perform for the billable hours program.

The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that the OIG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The OIG believes the evidence obtained provides a reasonable basis for the audit findings and conclusions based on the audit objectives.

OVERALL EVALUATION

The allocation system as explained and demonstrated by CILS management provides a reasonable basis for allocating indirect costs to LSC funds. However, while the new accounting manual provides a general description of the system, the description is not detailed enough to understand how the system actually operated. It was necessary for the OIG to receive a demonstration and a “walk-through” of the system in order to reasonably understand the allocation system. In regard to allocating attorney incentive payments, for payments made in 2009, CILS management instituted a policy to allocate these payments to the fee for service program only. However, the 2008 attorney incentive payments totaling over \$60,000 were recorded in a shared overhead account, a portion of which was allocated to LSC funds. The OIG questions the portion of the attorney incentive payments improperly charged to LSC funds in 2008 and will refer the amount as a questioned cost to LSC management in accordance with 45 C.F.R. § 1630.7.

RESULTS OF AUDIT

ALLOCATION SYSTEM DOCUMENTATION

While CILS’ new accounting manual contains a description of the allocation system, including how direct payroll expenses are used as the basis for allocating other indirect costs, the description does not capture all key steps associated with the system’s operation. The allocation system is complex, using three software programs and requiring many manual transfers of information to spreadsheets.

In addition, the system operator is required to have detailed knowledge of all grants that impact the allocation of costs for each funding source. For instance, some funding sources limit the amount of overhead that can be charged to the grant. The allocation system requires many steps in order to properly compute and apply the percentages used to allocate indirect costs. Therefore, if the person most knowledgeable of the allocation system should leave, it would be very difficult, and take an extended period of time, for a new person to identify all the steps required to operate the system and ensure that the system is making allocations as designed.

Having a fully documented allocation system improves internal controls by helping ensure that the system is operated properly, that funds are fairly and accurately charged

to the appropriate funding sources, and that the organization is protected should a key staff member leave.

Recommendation 1. The Executive Director should ensure that the allocation system is documented in sufficient detail to capture all key steps and processes, including steps to review grants annually for any changes to factors impacting cost allocation amounts.

Grantee Response. CILS management agrees to Recommendation 1. The step by step documenting of the allocation system will involve a multi-staff effort. The grantee plans to complete a draft document by July 31, 2011.

ATTORNEY INCENTIVE PAYMENTS

In 2008, three attorney incentive payments were recorded in a shared account and a portion of each payment was improperly allocated to LSC funds. A review of the 2008 attorney incentive payments disclosed that of the \$60,315 paid, approximately \$27,600 was improperly allocated to LSC funds. However, CILS changed its policy in 2009 and all four attorney incentive payments for that year were recorded in the proper account, no portion of which was allocated to LSC funds.

In explaining its prior practice, CILS management represented that for 2008, the amount of the attorney incentive payments allocated to LSC funds was less than the amount of non-LSC funds that were transferred to LSC to cover the overall shortfall in the LSC grant. Thus, in CILS' management's view, there was no impact on the use of the LSC grant as a result of allocating a portion of the attorney incentive payments to LSC funds. According to information supplied by CILS' management for the 2008 grant year, \$180,000 of non-LSC funds had to be transferred to the LSC fund to cover the short fall between the amount of the LSC grant and the amount charged to the grant. A review of the CILS' audited financial statements for fiscal years 2008 and 2009 disclosed non-LSC funds were transferred to the LSC Native American Grant in the amounts of \$134,476 and \$62,714, respectively.²

The OIG's discussion with LSC Headquarters staff and a review of the Accounting Guide for LSC Recipients (Paragraph 2-2.8, Net Assets) indicated that transferring monies from non-LSC funds to cover deficits in LSC funds was an accepted practice and the LSC preferred way to handle such deficits. This practice eliminates the need (as required by 45 C.F.R. § 1628.5, Fund balance deficits) for the recipient to obtain prior written approval from LSC to use current year LSC grant funds to liquidate deficit balances in the LSC fund from a preceding period.

² Grantee management provided information on the amount transferred for each of the grant years reviewed. Grant years are on a calendar year basis. CILS financial statements are based on a fiscal year end of June 30. While the audited financial statements confirmed the practice, the numbers provided by management and the amount contained in the financial statements did not match because of the 6-month difference between the end of the grant year (December 31) and the end of the fiscal year (June 30).

As the OIG understands this practice, the recipient reports in the LSC required supplemental schedule³ to the financial statements a line item that represents funds were transferred from a non-LSC source in a lump sum amount necessary to cover the deficit in the LSC fund. During the course of our on-site fieldwork at CILS, grantee management represented that this amount is not entered into the accounting records as an adjustment, nor is the amount distributed among the expense categories listed on the supplemental schedule⁴. From our discussions with LSC management, however, this transfer practice was apparently designed to prevent negative fund balances, not to substitute for accurately accounting for and allocating charges to LSC funds.⁵

The OIG does not believe the transfer of non-LSC funds, reported on a supplemental financial schedule, at the end of the year to cover a deficit in LSC funds meets the requirements of 45 C.F.R. Part 1630, Cost Standards and Procedures. The transfer recorded on the supplemental schedule does not distribute the funds to any specific expense account such as salaries, employee benefits, rent, office supplies and the like. The lump sum amount is added to the net asset figure simply to zero out any negative balance in net assets. Therefore, the lump sum is not adequately and contemporaneously documented in business records to indicate what amount is applicable to which expense. The OIG questions the \$27,600 in attorney incentive payments improperly charged to LSC funds in 2008 and will refer the amount as a questioned cost to LSC management in accordance with 45 C.F.R. § 1630.7.

OIG Comment. Since grantee management has implemented procedures, and the OIG has verified those procedures, to prevent attorney incentive payments from being charged to LSC funds in the future, no recommendation is necessary at this time.

Grantee Comment. CILS management has reviewed OIG's comment regarding attorney incentive payments. Since the matter has been referred to LSC management, CILS will await LSC management's determination prior to responding to this issue.

OIG EVALUATION OF GRANTEE COMMENTS

Management comments and actions taken are responsive to the issues raised in this report. Subsequent to receiving grantee's comments, CILS management provided step-by-step procedures documenting, in detail, the cost allocation system. These procedures are responsive to the recommendation. Therefore, Recommendation 1 is considered closed.

³ The title of the supplemental schedule is Schedule of Revenue, Support, Expenses, and Changes in Net Assets for LSC Funds.

⁴ It is not clear to the OIG from which funding sources these funds were transferred.

⁵ While this practice simplifies handling LSC fund balance deficits, it may have unintended consequences of encouraging or perpetuating poor accounting methods for LSC funds. This issue will be forwarded to LSC management for review.

The OIG will await LSC management's decision regarding the referred questioned costs of \$27,600 in attorney incentive payments charged to LSC funds. LSC management will communicate its decision on this matter directly to CILS.



CALIFORNIA INDIAN LEGAL SERVICES

BISHOP · ESCONDIDO · EUREKA · SACRAMENTO

Principal Office

609 S. Escondido Blvd., Escondido, CA 92025 ~ Phone: 760.746.8941 ~ Fax: 760.746.1815

www.calindian.org ~ contactCILS@calindian.org

Devon Lee Lomayesva, Executive Director

June 24, 2011

Via Email to ARAMIREZ@oig.lsc.gov

Anthony M. Ramirez, J.D., C.P.A.
Audit Team Leader
Legal Services Corporation
Office of the Inspector General

Dear Mr. Ramirez:

Per our recent conversation regarding CILS' request for clarification on the OIG Final Report recommendations, CILS submits the following response.

Recommendation 1. The Executive Director should ensure that the allocation system is documented in sufficient detail to capture all key steps and processes, including steps to review grants annually for any changes to factors impacting cost allocation amounts.

CILS agrees to this recommendation. The step by step documenting of the allocation system will involve a multi-staff effort and therefore CILS requests additional time to complete this documentation. CILS can provide a draft document to the OIG by July 31, 2011.

CILS has reviewed the comment by the OIG regarding CILS attorney incentive payments and understands the issue has been referred to LSC management. CILS will await contact by LSC management in order to respond to this issue.

Please contact me via email at dlomayesva@calindian.org or 760-746-8941 ext. 119 with any questions. Thank you for your time and I look forward to your response.

Sincerely,

CALIFORNIA INDIAN LEGAL SERVICES

Devon Lee Lomayesva
Executive Director