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May 27, 2015

Ms. Silvia Argueta
Executive Director
Legal Aid Foundation of Los Angeles
1102 Crenshaw Blvd.
Los Angeles, CA 90019

Dear Ms. Argueta:

Enclosed is the Office of Inspector General's (OIG) final report for our audit of Selected Internal Controls at Legal Aid Foundation of Los Angeles. The OIG has reviewed your comments on the findings and recommendations in the draft report. Your comments are included in the final report as Appendix II.

The OIG considers grantee actions taken or planned as responsive to 13 of our 14 recommendations. However, the comment for recommendation 13 is considered unresponsive because it does not address the actions planned to be taken to ensure all contract documentation is maintained in the contract files. As such, this finding will remain open until the grantee adequately addresses the issue.

Recommendations 1, 2, 3, 5, 6, 7, 8, 10, 11, 12, and 14 are still considered open until the OIG is notified in writing that the planned actions have been completed and implemented. Recommendations 4 and 9 are considered closed.

We thank you and your staff for your cooperation and assistance.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: <u>Legal Services Corporation</u>
Jim Sandman, President
Lynn Jennings, Vice President for Grants Management

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

LEGAL AID FOUNDATION OF LOS ANGELES

RNO 805080

Report No. AU 15-07

May 2015

www.oig.lsc.gov

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INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at the Legal Aid Foundation of Los Angeles (LAFLA or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's program administration office in Los Angeles, CA and at LSC headquarters in Washington, DC.

In accordance with the Legal Services Corporation Accounting Guide for LSC Recipients (2010 Edition) (Accounting Guide), Chapter 3, an LSC grantee "...is required to establish and maintain adequate accounting records and internal control procedures." The Accounting Guide defines internal control as follows:

> [T]he process put in place, managed and maintained by the recipients' board of directors and management, which is designed to provide reasonable assurance of achieving the following objectives:
>
> 1. safeguarding of assets against unauthorized use or disposition;
> 2. reliability of financial information and reporting; and
> 3. compliance with regulations and laws that have a direct and material effect on the program.

Chapter 3 of the Accounting Guide further provides that each grantee "must rely... upon its own system of internal accounting controls and procedures to address these concerns" such as preventing defalcations and meeting the complete financial information needs of its management.

BACKGROUND

The Legal Aid Foundation of Los Angeles (LAFLA) provides civil legal services to poor and low-income people in greater Los Angeles area. LAFLA has six neighborhood offices, three domestic violence clinics and four self-help legal access centers, serving communities such as East Los Angeles, the Westside, South Los Angeles, Pico-Union, Koreatown and Long Beach.

LAFLA receives funding from a wide range of public and private sources such as government agencies, law firms, corporations, foundations, and individual donors. LSC is the grantee's largest funding source. Additional funding is provided by grants from the State Bar of California's Legal Services Trust Fund Program (IOLTA), US Department of Health and Human Services Office of Refugee Resettlement, US Department of Justice, United Nations, County and City of Los Angeles, Los Angeles Homeless Services Authority, City of Santa Monica, City of Long Beach, and private foundations such as the California Community Foundation, and Weingart Foundation.

According to the audited financial statements for the grantee's year ended December 31, 2013, the total LSC and non-LSC funding received by the grantee was $26,947,283 (including donated services and capital campaign contributions). Approximately 25 percent of the grantee's total support funding was provided by Legal Services Corporation in the amount of $6,843,280 and approximately 75 percent from non-LSC funding in the amount of $20,104,003

OBJECTIVE

The overall objective was to assess the adequacy of selected internal controls in place at the grantee as the controls related to specific grantee operations and oversight, including program expenditures and fiscal accountability. Specifically, the audit evaluated selected financial and administrative areas and tested the related controls to ensure that costs were adequately supported and allowed under the LSC Act and regulations.

AUDIT FINDINGS

To accomplish the audit objective, the OIG reviewed and tested internal controls related to cash disbursements, credit cards, cost allocation, contracting, fixed assets, derivative income, client trust funds, internal reporting and budgeting, payroll and employee benefits. While many of the controls were adequately designed and properly implemented as they related to specific grantee operations and oversight, some controls need to be strengthened and formalized in writing. The OIG identified the areas listed below that need to be improved.

Derivative Income

The grantee receives derivative income in the form of attorneys' fees, rental income, unrealized gains/losses and interest income. The written policies and procedures for unrealized gains/losses and interest income were adequate and in accordance with the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide. However, written policies for attorneys' fees and rental income were not included in the grantee's Accounting Manual. We also found that the methodology for allocating attorneys' fees was not in accordance with 45 CFR §1609.4. Lastly, we found an error in the grantee's allocation of interest income.

Lack of Written Policies

Our review of LAFLA's Accounting Manual revealed that there were no written policies and procedures in place for recording and allocating attorneys' fees and rental income to the various funding sources.

45 CFR § 1609.6 specifically provides that grantees shall adopt written policies and procedures to guide its staff in complying with this regulation. In addition, the Accounting Guide, Section 3.4, provides that each grantee must develop a written

accounting manual that describes specific procedures to be followed by the grantee in complying with the *Fundamental Criteria*.

Without detailed written procedures, there could be a lack of transparency and consistency in the application of the methodology especially in cases of staff turnover. Documented policies and procedures detail the process steps, document the design of controls, and communicate the controls to the staff to help the grantee ensure that proper controls are followed.

Attorneys' Fees

The OIG's testing of attorneys' fees revealed that although the grantee allocated at least as much attorneys' fees to the LSC fund as required by the regulation, the method for allocating attorneys' fees revenue was not in accordance with 45 CFR §1609.4. The OIG selected five attorneys' fee line items included in the general ledger, which represented three LAFLA cases. The revenue for the line items tested totaled $273,152. The total amount of attorneys' fees recorded during the audit period was $308,046 according to the grantee's general ledger. During discussions with the Director of Fiscal Management, she stated that attorneys' fees were allocated to funding sources based on how the employee's salary is originally budgeted to the various grants, as opposed to how much time the attorneys actually expended on the specific cases awarded fees. The OIG's testing of time reported on these cases revealed that the grantee credited LSC funds with an additional $41,722 in attorneys' fees, based on our sample[1]. According to LAFLA management, to ease the allocation of attorney fee revenue, the attorney fee revenue is allocated to the funding source that the employee's salary is assigned as opposed to actual hours worked on cases.

45 CFR §1609.4(a) states:

> "Attorneys' fees received by a recipient for representation supported in whole or in part with funds provided by the Corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of Corporation funds expended bears to the total amount expended by the recipient to support the representation."

By allocating attorney fees based on budgeted hours as explained by the Director of Fiscal Management, the grantee is not in compliance with LSC's regulation's required methodology. Although in this case LSC funds were adequately credited for attorneys' fees received, using budgeted amounts instead of efforts expended could, in other cases, result in inadequate allocation to the LSC fund.

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[1] In this particular case, the grantee was awarded $47,440 in attorney fees and credited the total amount to LSC. Based on an hourly report of time charged to the case by LAFLA's attorneys, we calculated that approximately 12.72% of those hours were charged to LSC funding. As such, in accordance with the regulation, only $6,038 of the revenue was required to have been credited to LSC. Crediting more than this amount to the LSC fund does not violate the regulation, however.

Interest Income

The grantee's interest income was not allocated properly to LSC. The grantee followed its written policy, but used the wrong revenue amount in performing its interest calculation. The grantee generally uses the monthly revenue amount per the monthly remittance document received from LSC, as the basis for allocating interest income to LSC. Our recalculation of the interest income allocation based on the grantee's formula found that the revenue amount used to calculate the LSC portion of the interest income in the general ledger did not match the monthly revenue amount included in the monthly remittance. There was an estimated variance of $788.82 of the interest income allocated to LSC according to the OIG's recalculation. The $788.82 is about 3.2 percent of the total 2014 interest income earned of $24,765. According to the Director of Fiscal Management, the reason for the error was the revenue amount included in the interest income calculation was not updated at the beginning of the year. After the OIG inquiry, the Director of Fiscal Management stated the correction to the amount of revenue that should be earning interest had been made.

45 CFR §1630.12 states:

> "Derivative income resulting from an activity supported in whole or in part with funds provided by the Corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of Corporation funds expended bears to the total amount expended by the recipient to support the activity."

Properly recording interest income in accordance with LSC regulations allows funding sources to be allocated their apportioned share of income, which in turn can be used to provide legal services in accordance with LSC requirements.

Recommendations: The Executive Director should:

Recommendation 1: formalize written policies and procedures related to attorneys' fees and rental income within the LAFLA Accounting Manual in accordance with 45 CFR §1609.4(a) and the LSC Accounting Guide.

Recommendation 2: ensure that the methodology for allocating attorneys' fees is in accordance with 45 CFR § 1609.4(a).

Recommendation 3: ensure that the proper monthly revenue amount is used to allocate interest income to the related funding sources.

Employee Benefits

A member of the executive staff received eight salary advances between January 1 and October 31, 2014, which were in violation of the maximum number allowed to be received by an employee pursuant to the grantee's salary advance policy. Based on LAFLA's policy, no employee should receive more than four salary advances in a 12-month period, and no more than two in any six-month period. All eight salary advances received by the executive staff member were properly repaid in accordance with LAFLA's written policy.

The eight salary advances were approved by LAFLA's management staff. The executive staff member that received the salary advances did not seek nor receive Board of Directors' approval for the advances. OIG interviews with several management staff revealed they were not comfortable approving salary advances for their supervisor.

LAFLA's Personnel Manual 2009 states: "A salary advance will be given prior to a scheduled vacation or in an emergency situation, upon written request of the Directing Attorney or supervisor. No more than two salary advances will be approved in any six month period."

The policies in LAFLA's Personnel Manual have been established and approved by its Board of Directors. The salary advance policy is in the personnel manual. By not following the salary advance policy, management is not complying with the grantee's intentions in this area.

Recommendations: The Executive Director should:

Recommendation 4: ensure that all staff receive only the allowed number of salary of advances in accordance with LAFLA's written policy.

Recommendation 5: implement a policy that all salary advances to the Executive Director be approved by a member of the Board of Directors.

Payroll

Although the job duties and responsibilities of employees working in the grantee's payroll and human resources functions are adequately segregated, the ADP payroll system user profiles do not represent an adequate segregation of access within the system. In the OIG's review of the ADP payroll system, we found that all accounting staff are assigned as "super users," which allows them full access to process payroll as well as the ability to make any human resource changes to employee information including changes to salaries and benefits. According to LAFLA management, they were unaware of the "super user" capabilities of the Accounting staff within the ADP payroll system.

According to the LSC Accounting Guide, adjustments to payroll disbursements should be approved by an authorized individual independent of payroll preparation.

Also, the Accounting Guide requires that accounting duties be segregated to ensure that no individual simultaneously has both the physical control and record keeping responsibility for any asset, including but not limited to, cash, client deposits, supplies and property. Duties must be segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

A lack of segregation of payroll duties can provide an opportunity for fraud, abuse and misappropriation within the payroll system.

Recommendation 6: The Executive Director should ensure ADP user profiles are set to warrant adequate segregation of duties.

Property

Biannual Physical Inventory

The grantee did not maintain evidence that a biannual inventory of their property had been performed as required by LSC. The grantee did not retain sufficient evidence to substantiate that an inventory had been performed within the past two years and that the results had been reconciled to the property records. Without adequate evidence, the OIG could not confirm that management actually performed the inventory. According to LAFLA management, the physical inventory records are possibly lost. The OIG also tested controls over electronic devices (not part of the property inventory) and found that the grantee has laptops at three different locations. They have no other electronic type devices such as tablets or cell phones. They maintain a sign in/out sheet for the laptops which we reviewed for two of the three locations. The OIG determined the controls over these laptops appeared adequate.

The Accounting Guide, Section 2-2.4 states: "For property control purposes, a physical inventory should be taken and the results reconciled with the property records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference, and the accounting records should be reconciled to the results of the physical inventory with an appropriate note included in the financial statements, if determined to be material by the recipient's auditor."

Properly accounting for fixed and physical assets enables the grantee to safeguard and fully account for the assets purchased and support reconciliations so that property asset balances are accurate.

Property Listing

The grantee could not provide a property listing that included all of the property fields detailed by LSC's *Fundamental Criteria*. According to discussions with the Director of Fiscal Management, due to a lack of staff, the grantee doesn't have an employee dedicated to maintaining fixed asset schedules in accordance with LSC requirements. Upon request of the LAFLA property records, we received only the depreciation schedule. While the depreciation schedule identified the item description, acquisition date, useful life, original cost and depreciation, it did not contain other identifying items required by LSC's *Fundamental Criteria* including:

- the check number used to pay for item;
- the source of funds used for acquisition;
- the description of how value was assigned if donated;
- the location and condition of the property item;
- the inventory control number/tag; and
- the date and method of disposal and sales price.

According to the LSC Accounting Guide, Section 3-5.4, property purchases should be recorded in a property subsidiary record. The property record should include a property description, the date acquired, check number, original cost, fair value (if donated), method of valuation (if donated), salvage value (if any), funding source, estimated life, depreciation method, identification number and location. The property subsidiary record must agree with the general ledger property accounts.

Recommendations: The Executive Director should ensure that:

Recommendation 7: the grantee conducts a physical inventory and documents the results of inventory counts and reconciliations to property subsidiary records and the General Ledger.

Recommendation 8: adequate property records are maintained and include all data fields required by LSC's *Fundamental Criteria*.

Disbursements and Credit Cards

In general, the OIG found that the grantee's disbursements were adequately supported and allowable. With respect to credit cards, our review revealed that for all of the credit card transactions reviewed and tested, the charges were properly supported and allowable. However, when we reviewed the credit card transactions of the Executive Director, we found that she had approved her own credit card statements throughout the audit period. No other credit card holder approved their own credit card charges. LAFLA has five credit card holders: the Executive Director, the Director of Human Resources (HR) and Administration and office managers in three field offices. The OIG tested credit card transactions related to the Executive Director and the Director of HR and Administration.

The credit cards tested included both gas and corporate cards. The transactions reviewed were supported and allowable. During testing of three credit card statements, the OIG determined the Executive Director's credit card transactions were self-approved. According to discussion with the Director of Fiscal Management, LAFLA is a small organization and no need exists for Board approval of all the Executive Director's transactions, especially since most of the transactions were not material in amount and were routine in nature. Although it may be inconvenient or time consuming to secure Board approval, by not doing so, the grantee is directly violating its written policy on Executive Director credit card approval.

The grantee's written policy dictates the Executive Director's credit card statement will be sent to the Board President via email with a PDF statement and receipts for review and approval.

The Accounting Guide Section 3-5.4 states: "Purchase approvals should be required at an appropriate level of management before a commitment of resources is made."

Also, as written in LAFLA's Accounting Manual, Cash Disbursements, Credit Cards section: "Each statement must be signed by each manager and must have receipts for each purchase."

Failure to follow the appropriate approval processes may result in inappropriate authorization of expenses and abuse of funds.

Recommendation 9: The Executive Director should ensure the grantee follows its written credit card policy with respect to her transactions. The Executive Director's credit card transactions should be reviewed and approved periodically, by someone other than herself, preferably the Board President, pursuant to the grantee's written policy.

Cost Allocation

Written Policy

The grantee's written policy is more of a high level overview of the cost allocation process, as it lacks specific details pertaining to the methodology and process used in allocating both direct and indirect costs to the funding sources. The written policy would conform to LSC's *Fundamental Criteria* if it detailed the specific methodology and process used by the grantee.

Nevertheless, the generally described written process is not what the grantee practices. Our review of LAFLA's cost allocation process found that the practice in place for allocating costs does not reflect what is stated in its written policy and is not consistently applied as explained by LAFLA management. The actual practice in place does not appear to be in accordance with the LSC *Fundamental Criteria*. We found major differences between the grantee's written policy and actual practice. For example, as to direct personnel costs, LAFLA's written cost allocation policy and procedures states that time is pro-rated among grants based on actual staff hours expended on each grant. However, based on test work performed, the OIG found that LAFLA uses a personnel grid with budget staff hours to allocate time to grants.

As part of an internal control structure, each grantee must develop a written accounting manual that describes the specific procedures to be followed by the grantee in accordance with the *Fundamental Criteria* and the LSC Accounting Guide, which require that financial controls be established to safeguard program resources.

Cost Allocation Methodology

In practice, the grantee does not appear to be using a rational and systematic basis for allocating indirect costs. With respect to the allocation of indirect costs, it is mostly at the personal discretion of the Director of Fiscal Management. The entire cost allocation process needs to be reworked with a written policy that reflects a rational and systematic practice in place.

The current written cost allocation procedure for indirect costs states that costs are allocated to the funding sources based on budgeted full time equivalents assigned to the various grants. In practice, LAFLA initially allocates costs to a General account and to LSC when the invoice is received and coded. The cost is then reallocated to the other funding sources at the end of the quarter based on staff headcount. At the end of each quarter a summary of expenses is prepared to determine re-allocations from LSC to other grants that allows for indirect costs, such as CalWorks, IOLTA and Equal Access Fund; however, these quarterly re-allocations are not based on full time equivalents. Instead, according to the Director of Fiscal Management, they are based on expenses for the location as a whole. For many of the quarterly re-allocations of the indirect costs, we tried to test the allocations, but we found that the costs were not allocated in accordance with any cost driver or other rational basis. The Director of Fiscal Management basically moved the funds among the various funding sources based on her own best judgment and knowledge. We reviewed funding source reports and journal entries which showed that the Director of Fiscal Management did allocate indirect costs to all of the grants that could take those costs.

The Accounting Guide, Section 3-5.9 states: "Common expenses shall be allocated among the sources on the basis agreed to by the applicable funding organizations, and in the absence of approved methods the allocation should be fair, consistent, and in equitable manner to the individual cost centers, and funds. Further, the allocation formula should be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO and others, to easily understand, follow and test the formula. Without a consistent and systematic basis for allocating indirect costs, there is no assurance that LSC or the other funding sources will receive their fair and equitable share of these costs.

Recommendations: The Executive Director should:

Recommendation 10: establish a fair, transparent, consistent and systematic cost allocation methodology in accordance with LSC requirements.

Recommendation 11: update LAFLA's current written cost allocation methodology to document the newly established methodology.

Contracting

Written Policies

LAFLA's written policies and procedures over contracting are mostly in accordance with LSC's *Fundamental Criteria*; however, we found that the following items were missing from the grantee's written policy and procedures:

- contracting procedures identified for the various types of contracts;
- a requirement of a written justification be included for sole source contracts;
- a specific minimum number of bids required; and
- required documentation describing the process used for each contract, including a detailed statement of work.

According to LAFLA management, the missing written policies and procedures were due to an oversight. They did not realize that the policies were deficient.

As part of an internal control structure, each grantee must develop a written accounting manual that describes the specific procedures to be followed by the grantee in complying with the *Fundamental Criteria* and the LSC Accounting Guide, which require that financial controls be established to safeguard program resources.

The OIG sampled nine contracts. Six of the nine contracts were not sufficiently documented as required by LSC's *Fundamental Criteria*. Specifically, the missing required documentation included:

- request for proposals
- sole source justifications
- evidence of competition
- reasons for selection

The table below summarizes the results of our testing.

		Missing Required Documentation			
Contracts	*Contract Cost*	*Request for Proposals*	*Sole Source Justification*	*Evidence of Competition*	*Reason of Selection*
Contract 1	$5,853/mo.	☑		☑	☑
Contract 2	$61.88/hr.	☑			☑
Contract 3	$6,000/mo.		☑		
Contract 4	$12,000		☑		
Contract 5	$22,000				☑
Contract 6	$19,295		☑		

(OIG noted that LSC funds were not used for Contracts 4, 5 and 6.)

In addition, for Contracts 1 and 2, LAFLA incurred and paid expenses from January 1, 2014 to October 31, 2014 for janitorial contract services with a total amount of $78,881.73 and security contract services with a total amount of $88,757.50. Both of these services were provided from the same contractor. Neither contract for janitorial nor security services has been re-opened for bid since 2008.

The Accounting Guide, Section 3-5.16 provides that management should identify the contracting procedures for the various types of contracts, dollar thresholds, and competition requirements. Contracts that should receive additional oversight include consulting, personal service, and sole-source.

The process used for each contract action should be fully documented and the documentation maintained in a central file. Any deviations from the approved contracting process should be fully documented, approved, and maintained in the contract file. In addition, the statement of work should be sufficiently detailed so that contract deliverables can be identified and monitored to ensure that deliverables are completed.

The type and dollar value of contracts requiring competition should be included in the grantee's policies. Documents to support competition should be retained and kept with the contract files.

The required approval level (including items that need to be approved by LSC) should be established for each contract type and dollar threshold, including when the Board of Directors should be notified and/or give approval.

Contracting is a high-risk area for potential abuse. Weak contracting practices and procedures can result in improper use of funds. Also, without competitive bidding, goods and services may be obtained at unfair prices, could possibly result in a conflict of interest and the grantee may not receive the best services available.

Recommendations: The Executive Director should:

Recommendation 12: ensure all written contracting policies are updated and reflect the requirements detailed in LSC's *Fundamental Criteria.*

Recommendation13: ensure all relevant documentation detailed in the finding above be included and maintained in the grantee's contract file.

Recommendation 14: if possible, reopen contracts 1 and 2 for bidding to the public to ensure that the grantee is receiving the best price and service available.

SUMMARY OF GRANTEE MANAGEMENTS COMMENTS

LAFLA management agreed with 10 of the 14 findings and recommendations stated in the draft. They disagreed with 3 of the findings and recommendations, and were unresponsive to one. The findings and recommendations covered derivative income and attorney fees, employee benefits, payroll, property, disbursements/credit cards, cost allocation and contracting. The response also provided technical corrections to our Background section, which we implemented.

With respect to derivative income, LAFLA management will adopt policies and procedures for accounting attorneys' fees and rental income and will ensure the methodology for allocating attorneys' fees is in accordance with the regulations. Additionally, LAFLA will ensure the proper monthly revenue amount is used to allocate interest income to the related funding sources.

LAFLA management believes that they adhered to their policy with respect to giving the Executive Director eight pay advances. The grantee feels that the OIG did not interpret their policy correctly and four of the payments made to the Executive Director were early paychecks, not salary advances. LAFLA's personnel policy allows for early paychecks and salary advances for staff for a total of four salary advances and four early paychecks in a 12 month period. Grantee management states that an early paycheck is defined as a check for wages already earned, and issued prior to the regularly scheduled pay day; a salary advance is defined as a pay check issued against earned annual leave. Also, grantee management states that they will adopt a written policy to require Board member approval for the Executive Director's early paychecks and salary advances.

LAFLA management stated that they have confirmed with ADP payroll system that accounting staff have never had or have never been assigned as "Super Users" and that ADP does not use that terminology. They stated that they have confirmed the ADP user profiles are and have been set to insure adequate segregation of duties. As such, LAFLA disagrees with the OIG's finding in this area.

The grantee stated that they will update their physical inventory document to ensure that it includes all data fields required by LSC's *Fundamental Criteria.* They further state that most of the items in their inventory are donated items, with no clear valuation. They will create a method of valuation for these items. Finally the grantee will document the results of the inventory and reconciliation to property subsidiary records and the General Ledger.

Grantee management explained that the Executive Director's credit card transactions have been routinely reviewed and approved by the President of the Board of Directors since the inception of the written policy. They stated that they discussed this with the OIG Audit team, and that the lapse in review and approval for the review period was due to staffing changes in the Executive Office and Finance Department, and layoffs in 2013. Also, the Director of Fiscal Management disputes the statement attributed to her in the OIG draft report that LAFLA is a "small organization" or that no need exists for Board approval of all of the Executive Director's transactions when she knows the policy.

With respect to cost allocation, grantee management stated that they will review, provide more detail and update the current written cost allocation methodology and process used in allocating both direct and indirect costs to the funding sources.

The response stated that the grantee will ensure that the Accounting Manual is updated to reflect the contracting requirements detailed in LSC's *Fundamental Criteria* and in the draft report. LAFLA management stated that they do seek three bids for its contracts as a routine practice and obtains documentation from each bidder. They also state that they seek the best pricing with the limited funds they have and rely on competitive bidding for goods and services as appropriate.

Grantee management stated that they re-opened the bidding process for contracts 1 and 2 on May 8, 2015 and has released an RFP for both of those services. They are awaiting responses from several vendors.

<u>THE OIG'S EVALUATION OF MANAGEMENT'S RESPONSE</u>

The OIG considers the grantee's planned actions responsive to Recommendations 1, 2, 3, 5, 7, 8, 10, 11, 12 and 14. As such, Recommendations 1, 2 and 3 will remain open until the grantee management adopts policies and procedures for attorneys' fee and rental income. The recommendation will remain open until they implement procedures to ensure that the proper monthly revenue number is used to allocate interest income.

Recommendation 5 will remain open until grantee management implements a policy that all salary advances to the Executive Director be approved by a member of the Board of Directors.

Recommendations 7 and 8 will remain open until the grantee establishes procedures for documenting its biannual physical inventory and reconciling the count to the general ledger.

Recommendations 10, and 11 will remain open until the grantee establishes a sound cost allocation methodology and documents written procedures related to that methodology in their accounting manual.

Recommendations 12 and 14 will remain open until the grantee has updated their contracting policies and provided LSC with evidence that the contracts for janitorial and security services were put out for re-bid on May 8, 2015.

All of the recommendations above will remain open until the grantee has provided the OIG written confirmation that the grantee's planned actions have been adequately completed.

Grantee management did not agree with our Recommendations 4, 6, 9 and 13 and related findings. With respect to Recommendation 4, the grantee made representations to the OIG on site that all the pay advances granted to employees were salary advances, not early paychecks. The Director of Fiscal Management provided the OIG with a list that was entitled "Salary Advances" for all of those payments. Also, every advance on that list had a pay date and we determined through our review of payroll records that all pay advances were paid back on that specific pay date. However, if an early check is backed by wages already earned and issued, there should be no payback date for those funds. Only true salary advances need to be paid back.

Consequently, the OIG views all of those payments made to the Executive Director and other employees as salary advances and we maintain that our finding and recommendation are correct and accurate based on the representations, interviews and documentation provided to us by the grantee while we were onsite. Management noted in their response that the OIG did not interview the staff member who approves salary advances. The OIG interviewed the Director of Fiscal Management who should be more than familiar with LAFLA financial policy. Management's comment is not merited in the context of this funding. However, based on the new information provided to us by the grantee in their response, related to early paychecks, we are willing to accept the fact that the grantee considers four of the Executive Director's salary advances to be early paychecks and they believe they are in compliance with their policy. Therefore, we will close the related recommendation.

The grantee also did not agree with our finding and Recommendation 6 related to adequate segregation between the payroll and human resources function, specifically with regards to ADP profiles. The Director of Fiscal Management provided the OIG an

ADP generated document showing user profiles. A copy of this document is in our workpaper file. The document clearly shows four users in that ADP generated profile, with two being Super Users. Those two Super Users were the Director of Fiscal Management and the Accountant. The Director of Fiscal Management explained that the Super Users have total unfettered access within the ADP system. The grantee's response to this finding in the draft report contradicts our documentation. This document also contradicts LAFLA's statement that the "accounting staff have never had or have never been assigned as "super users" and that ADP does not use that terminology." Based on the representations made to us on-site by LAFLA staff, discussions with the Director of Fiscal Management and the documents provided to us, we stand behind this finding and recommendation. To properly respond to this recommendation, LAFLA must provide the OIG with a screenshot of the ADP user profile showing that these privileges have changed and that adequate segregation of duties exists.

For Recommendation 9 related to reviews of the Executive Director's credit card transactions, we disagree with the grantee's response. While LAFLA provides an explanation that there was a lapse in review due to staff layoffs in 2013, there is still no indication that the transactions were approved. Regardless of the reasons provided by LAFLA in the response, the Executive Director is well aware of the requirement that the Board President is required to review and approve the Executive Director's credit card transactions. No proof of any review has been provided to the audit team. We also take exception to the Director of Fiscal Management's comments that our report is incorrect. We interviewed the Director of Fiscal Management and she provided an explanation that we included in our draft report. In fact, the OIG asked the Director of Fiscal Management more than once why the Executive Director's travel wasn't approved by a board member and we received the same answer multiple times. We stand by what was told to us by the Director of Fiscal Management and stated in the draft report. The grantee's new explanation in their response, which was not communicated to us while we were on site, explained why the Executive Director's travel was not approved by a board member. Because of this explanation and that the transactions were well supported and authorized by LAFLA policy, we consider this finding closed.

We believe the grantee was unresponsive to Recommendation 13. The finding has to do with ensuring that all contract documentation was maintained in the grantee's contract file as required by LSC's *Fundamental Criteria*. The grantee does not mention how they plan to address this issue. As such, this finding will remain open until the grantee adequately addresses the issue.

SCOPE AND METHODOLOGY

To accomplish the audit objective, the OIG identified, reviewed, evaluated and tested internal controls related to the following activities:

- Cash Disbursements,
- Client Trust funds,
- Contracting,
- Cost Allocation,
- Credit Cards,
- Derivative Income,
- General Ledger and Financial Controls,
- Internal Management Reporting and Budgeting,
- Property and Equipment, and
- Payroll
- Employee Benefits

To obtain an understanding of the internal controls over the areas reviewed, grantee policies and procedures were reviewed including manuals, guidelines, memoranda and directives, setting forth current grantee practices. Grantee officials were interviewed to obtain an understanding of the internal control framework and management and staff were interviewed as to their knowledge and understanding of the processes in place. To review and evaluate internal controls, the grantee's internal control system and processes were compared to the guidelines in the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide. This review was limited in scope and not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

We assessed the reliability of computer generated data provided by the grantee by reviewing source documentation for the entries selected for review. We determined the data were sufficiently reliable for the purposes of this report.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample consisted of 90 disbursements totaling $450,539.69. The sample represented approximately 9.5 percent of the $4,763,683.60 disbursed for expenses other than payroll during the period January 1, 2014 to October 31, 2014.

To assess the appropriateness of expenditures, we reviewed invoices and vendor lists and traced the expenditures to the general ledger. The appropriateness of those expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations and LSC policy guidance.

To evaluate and test internal controls over the salary advances, contracting, property and equipment, internal management reporting and budgeting and client trust funds, we interviewed appropriate program personnel, examined related policies and procedures and selected specific transactions to review for adequacy.

To evaluate the adequacy of the cost allocation process, we discussed the cost allocation process for the scope period with grantee management and reviewed the grantee's written cost allocation policies and procedures as required by the LSC Accounting Guide. We tested the cost allocation amounts and reviewed the related reclassification entries using the information provided by the grantee.

To assess controls in payroll, we conducted interviews of appropriate program personnel and reviewed system user access levels for proper segregation, to ensure there was no inappropriate overlap between the payroll and human resources functions.

Controls over derivative income were reviewed by examining current grantee practices as well as the written policies contained in the grantee's Accounting Manual. To evaluate controls over client trust fund accounting, we interviewed appropriate program personnel, examined related policies and procedures and performed recalculations of some revenue accounts.

The on-site fieldwork was conducted from December 3, 2014 through December 12, 2014. Our work was conducted at the grantee's program administration office in Los Angeles, CA and at LSC headquarters in Washington, DC. We reviewed documents pertaining primarily to the period January 1, 2014 through October 31, 2014.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require the audit be planned and performed 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 findings and conclusions based on the audit objectives.

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Legal Aid Foundation of Los Angeles

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May 13, 2015

Mr. Anthony M. Ramirez
Director of Planning, Policy and Reporting
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3333 K St. N.W., 3rd Floor
Washington, DC 20007-3558

RE: Response to your letter dated April , 2015 regarding the Draft Report on results of our Audit on Selected Internal Controls – Recipient 805080

Dear Mr. Ramirez:

The Legal Aid Foundation of Los Angeles (LAFLA) received the Office of Inspector General (OIG) Draft Report on the results of your audit on Selected Internal Controls at LAFLA -Recipient No. 805080 . Our comments are attached.

If you have any questions or need additional information, please contact me at 323-801-7906. I am pleased to inform you that Dionne Day is the new Chief Financial Officer at LAFLA. Ms. Day will be in charge of implementing the recommendations made by your team.

Best regards,

Silvia R. Argueta

Silvia R. Argueta
Executive Director

Enclosure

<u>Recommendations 1 , 2 and 3</u> *- The Executive Director should formalize written policies and procedures related to attorneys' fees and rental income within the LAFLA <u>Accounting Manual</u> in accordance with 45 CFR §1609.4(a) and the LSC <u>Accounting Guide and that the</u> methodology for allocating attorneys' fees is in accordance with 45 CFR § 1609.4(a).*

Ensure that the proper monthly revenue amount is used to allocate interest income to the related funding sources.

Response: LAFLA will adopt policies and procedures for accounting attorneys' fees and rental income and will ensure the methodology for allocating attorneys' fees in accordance with regulations. Additionally, LAFLA will ensure the proper monthly revenue amount is used to allocate interest income to the related funding sources.

- Appropriate Accounting staff will be trained on the correct procedures to identify records and report derivative income in accordance with LSC requirements.
- Continuous training and monitoring will be provided to the finance department to ensure compliance with LSC requirements.

<u>Recommendations 4 and 5:</u> *The Executive Director should ensure that all staff receive only the allowed number of salary advances in accordance with LAFLA's written policy and will implement a policy that all salary advances to the Executive Director be approved by a member of the Board of Directors.*

Response: LAFLA ensures that staff receive only the allowed number of salary advances and early paychecks in accordance with LAFLA's written policy. LAFLA's personnel policy allows for early pay checks and salary advances for staff for a total of four salary advances and four early paychecks in a 12 month period. An early pay check is defined as a check for wages already earned, and issued prior to the regularly scheduled pay day; a salary advance is defined as a pay check issued against earned annual leave. LAFLA believes it adhered to its written policies at all times with regard to salary advances and early paychecks. The management staff member who approves the salary advances and early paychecks was not interviewed by the OIG audit team.

LAFLA will adopt a written policy that all salary advances and early paychecks to the Executive Direct be approved by a member of the Board of Directors.

<u>Recommendation 6:</u> *The Executive Director should ensure ADP user profiles are set to warrant adequate segregation of duties.*

Response: LAFLA Human Resources personnel have confirmed with ADP payroll system that accounting staff have never had or have never been assigned as "super users" and that ADP does not use that terminology. The only staff allowed access to make Human Resources changes to employee information including edits, additions or deletions to employee's salaries and benefits are HR personnel. LAFLA adheres to the LSC Accounting Guide in that duties are segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

We have confirmed the ADP user profiles are and have been set to insure adequate segregation of duties.

Recommendations 7 and 8: *The Executive Director should ensure that the grantee conducts a physical inventory and documents the results of inventory counts and reconciliations to property subsidiary records and the General Ledger and that adequate property records are maintained and include all data fields required by LSC's Fundamental Criteria.*

Response: LAFLA will update its physical inventory document results to ensure that it includes all data fields required by LSC's *Fundamental Criteria.* LAFLA conducts a physical inventory that is managed by the three office managers and when applicable the IT staff for IT equipment.

Most of the items in our inventory are donated items. Many of those who donate items to us do not provide a valuation; we will create a method of valuation for these items. We will document the results of the inventory and reconciliation to property subsidiary records and the General Ledger.

Recommendation 9: *The Executive Director should ensure the grantee follows its written credit card policy with respect to her transactions. The Executive Director's credit card transactions should be reviewed and approved periodically, by someone other than herself, preferably the Board President, pursuant to the grantee's written policy.*

Response: The Executive Director's credit card transactions have been routinely reviewed and approved by the President of the Board of Directors since the inception of the written policy. As discussed with the OIG Audit team, the lapse in review and approval for the review period was due to staffing changes in the Executive Office and Finance Department due to the loss of staff thru layoffs in 2013. The Executive Director did not approve any of the transactions for the review period, her initials were simply acknowledgement of receipt. Staff is aware of the needed review and approval by the Board President and the policy is being followed; reinforcement of the policy and training have now occurred to remind staff of the policy and the need for appropriate approvals. All of the transactions were supported by receipts and allowable for LAFLA expenses. The Director of Fiscal Management does dispute the statement attributed to her in the OIG draft report as she knows and is aware of the credit card policy and would never say that LAFLA is a "small organization" or that no need exists for Board approval of all of the Executive Director's transactions when she knows the policy.

Recommendations 10 and 11 *- The Executive Director should establish a fair, transparent, consistent and systematic cost allocation methodology in accordance with LSC requirements and update LAFLA's current written cost allocation methodology to document the newly established methodology.*

Response: LAFLA will review, provide more detail and update the current written cost allocation methodology and process used in allocating both direct and indirect costs to the funding sources. Any assistance LSC Audit team can provide would be welcome.

Recommendations 12, 13 and 14 *- The Executive Director should ensure all written contracting policies are updated and reflect the requirements detailed in LSC's Fundamental Criteria. Ensure all relevant documentation detailed in the finding above be included and maintained in the grantee's contract file. If possible, reopen contracts 1 and 2 for bidding to the public to ensure that the grantee is receiving the best price and service available.*

Response: LAFLA will ensure that the Accounting Manual is updated to reflect the requirements detailed in LSC's *Fundamental Criteria* and in the draft report. LAFLA does seek three bids for its contracts as a routine practice and obtains documentation from each bidder. We are aware and seek the best pricing with the limited funds we have and rely on competitive bidding for our goods and services as appropriate. For contract 3, a contract labeled as a sole source, this contract was obtained after outreach to several vendors and IT consultants, and we will formalize the process in writing for any such future contracts. Contracts 4, 5, and 6 are contracts that are not funded by LSC and are funded exclusively by private donors. We have a project manager that oversees those contracts and vets each vendor. As to contracts 1 and 2, LAFLA did release an RFP in 2013 for janitorial and security services. Unfortunately, we did not receive competing bids as we requested that the vendors provide health insurance and pay for holidays and sick leave pay to its employees. We re-opened the bidding process for contracts 1 and 2 on May 8, 2015 and have released an RFP for both of those services. We are awaiting responses from several vendors.