Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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March 30, 2015

Mr. John H. Fitzgerald
Executive Director
Northeast New Jersey Legal Services Corporation
574 Summit Avenue
Jersey City, NJ 07306-2797

Dear Mr. Fitzgerald:

Enclosed is the Office of Inspector General's (OIG) final report for our audit of Selected Internal Controls at Northeast New Jersey Legal Services Corporation, Inc. 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 the proposed actions to address all Recommendations in the report as responsive. Recommendations 1, 3, 4, 6, 7, 8 and 9 will remain open until your Board of Directors approves the revised policies and the OIG receives written notification that the policies have been approved and implemented.

The OIG accepts your calculation of the amount of SSI reimbursements and attorneys' fees that should have been allocated to LSC. Based on the information you provided and accepted by the OIG, the total derivative income that should be allocated to LSC is $72,572. This amount will be referred to LSC management.

Since the actions implemented have fully addressed Recommendations 2, 5 and 10, we consider them closed.

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We appreciate the courtesy and cooperation you and your staff extended to us during the audit.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

Cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings
Vice President for Grants Management

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

NORTHEAST NEW JERSEY LEGAL SERVICES CORPORATION, INC.

RNO 331050

Report No. AU 15-04

March 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 Northeast New Jersey Legal Services Corporation, Inc. (NNJLS or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Jersey City, NJ 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 recipient's 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

NNJLS is a not-for-profit corporation whose mission is to ensure that access to the civil justice system is not denied to any resident simply because he or she cannot afford a private attorney. The grantee offers comprehensive legal representation to low-income, senior and disabled residents of Bergen, Hudson and Passaic Counties who have civil legal problems and cannot afford a private attorney. The grantee has offices in Hackensack, Paterson and Jersey City, NJ.

According to the audited financial statements for the grantee's year ended June 30, 2013, approximately 93 percent of the grantee's total support funding was provided by three funding sources: the State of New Jersey, LSC and Legal Services of New Jersey, Inc. NNJLS received $3,741,070 from the State of New Jersey, $1,651,636 from LSC and $560,350 from Legal Services of New Jersey, Inc. In addition, the grantee received $424,268 from the counties in which it operates, the Internal Revenue Service, Campaign for Justice and others.

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 LSC 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, salary advances, client trust funds and internal reporting and budgeting. 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 that the areas listed below need improvement.

CONTRACTS

The LSC OIG examined NNJLS's business arrangements during the audit period and determined that the grantee's contracting practices did not fully adhere to LSC guidelines and, in some instances, to the grantee's own Financial Policies and Procedures Guide (Procedures Guide). In addition, the grantee's Procedures Guide did not contain all of the elements required by the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide.

Contracting Practices

The LSC OIG judgmentally selected nine vendors for testing, and found that:

- None of the eight contracts subject to competitive bidding requirements were competitively bid;
- Sole source justifications were not prepared for contracts awarded without competition;
- Two contracts were not documented in writing; and
- One contract was not approved by the highest level approval authority stipulated by the grantee's Procedures Guide.

The OIG found that for two of the contracts subject to competitive bidding, both leases for office space, grantee management engaged in efforts to research and negotiate best price options. However, the grantee did not seek competitive bids from multiple vendors or document sole source justification.

The *Fundamental Criteria* stipulates that the type and dollar value of contracts that require competition should be included in the grantee's policies. Documents to support competition should be retained and kept with contract files. Further, it states that the process used for each contract action should be fully documented and the documentation maintained in a central file. Any deviation from the approved contracting process should be fully documented, approved, and maintained in the contract file. 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 provide approval.

NNJLS's contracting practices did not adhere to all the elements of the *Fundamental Criteria* in part because of grantee management's lack of understanding of its components and lack of adequate management oversight. In response to the OIG's recommendations, grantee management acknowledged the need for changes to its practices to conform to LSC guidelines and began working on drafting new policies and procedures.

By not subjecting contracts to competitive bidding and not documenting the reason the contracts were not subject to competition, it is not clear whether the grantee received the best price and service available for the money spent.

Written Policies

In our review of NNJLS's written contracting policies, the OIG noted that the grantee's Procedures Guide did not contain all key elements required by the *Fundamental Criteria* of the LSC Accounting Guide. The Procedures Guide did not outline policies for competition or for documenting deviations from approved contracting processes as required by the *Fundamental Criteria* of the Accounting Guide. It also did not distinguish between the different types of contracts, such as consulting, personal service and sole-source.

The *Fundamental Criteria* stipulates the type and dollar value of contracts requiring competition should be included in the policies of the grantee and documentation supporting competition should be retained and kept with contract files.

NNJLS's Procedures Guide states that telephone quotes are required for purchases under $5,000 and written quotes are required for purchases over $5,000, but it does not specify the number of quotes required. It also does not outline policies for documenting deviations from the approved contracting process, except for contracts that require approval from the funding source prior to execution.

NNJLS's policies also did not distinguish between types of contracts. The Procedures Guide states all contracts are subject to review and approval by the Executive Director. Dollar thresholds for approval are not established in NNJLS's written policies nor are procedures for the handling of contracts that should receive additional oversight such as consulting, personal service and sole source contracts, as suggested by LSC's *Fundamental Criteria*.

In addition, the *Fundamental Criteria* provides that each grantee must develop a written accounting manual describing the specific procedures to be followed by the grantee in compliance with the *Fundamental Criteria*. Fully documenting policies and procedures helps ensure that proper controls are followed, serves as a vehicle to communicate controls to all staff, and assists staff in understanding their roles and responsibilities.

Contracting is a high-risk area for potential abuse and contracting practices and procedures which do not fully comply with the *Fundamental Criteria* can result in improper use of funds.

Recommendations: The Executive Director should:

> Recommendation 1: enhance and revise existing written policies regarding contracting to ensure that they address the elements required by the *Fundamental Criteria* including contracting procedures for different types of contracts, competition, documentation and approval requirements. The policies should include procedures for deviating from the approved contracting process, such as when the grantee decides to execute sole-source contracts.
>
> Recommendation 2: ensure that a centralized contract filing system is created whereby each contract file relates to a specific contract and contains all pertinent documentary support related to the contract action, including the contract document, solicitation, receipt and evaluation of bids and the award of the contract.

DERIVATIVE INCOME

The OIG found that NNJLS did not allocate any State Supplemental Security Income (SSI) reimbursements, court awarded attorneys' fees or, interest income to LSC during the period under review. Also, they did not allocate the correct amount of rental income received to LSC.

As a result of a Case Service Report/Case Management System on-site visit from LSC's Office of Compliance and Enforcement in February 2014, NNJLS revised its derivative income policy. The proposed policy, which must be reviewed and approved by the Board of Directors at its next meeting, states the following:

> Interest, rental income and other derivative income received by the program are allocated back to the revenue source to which the expense that generated the income was originally allocated. If more than one source of revenue was used to generate the income then the derivative income is allocated proportionately based on the cost allocation of the expense among the revenue sources.

The proposed policy conforms to LSC regulations. The proposed policy was added to the Procedures Guide as an annex, but was not currently being followed in practice by the grantee. The OIG did not find any other written derivative income policy in place predating this proposed revision.

State Supplemental Security Income Reimbursements

NNJLS received $66,263 in State SSI reimbursements during the period under review. When NNJLS represents a client applying for need-based Social Security and the client is awarded benefits retroactively, the State of New Jersey pays a portion of the award to NNJLS to cover the cost of the case. These are State SSI reimbursements. The State SSI reimbursements received by the grantee during the audit period were allocated in their entirety to the unrestricted fund even though funds from a variety of sources, including LSC, were used to support the cases. NNJLS's Controller stated he does not track expenses by funding source for each case in order to allocate SSI funds received to the funding sources accordingly. However, the Executive Director told the OIG that the legal staff tracks expenditures by case and NNJLS could use the information to allocate State SSI reimbursements.

The OIG was not able to determine the exact amount of State SSI reimbursements that should have been allocated to LSC because the Controller was not able to provide a breakdown of how expenses for the cases were allocated between funding sources. It is our understanding that although the information was available to enable the Controller to allocate State SSI reimbursements appropriately, he did not use it.

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.

While onsite, we found that State SSI reimbursements were not allocated to LSC in accordance with the meaning of 45 CFR § 1630.12, and the OIG had no way of determining the amount that LSC should have received. After our site visit, grantee management determined that 27.9 percent of attorneys' salaries associated with the cases for which State SSI reimbursements were received were allocated to LSC. As a result, $18,487 in State SSI reimbursements (27.9 percent of $66,263) should have been allocated to LSC. The OIG is questioning $18,487 of State SSI reimbursements. The OIG will refer the questioned derivative income to LSC management for review and action.

Court Awarded Attorneys' Fees

During the period under review, NNJLS did not allocate any of its attorneys' fees income to LSC in accordance with LSC requirements. The entire $38,587 in attorneys' fees received during this period was recorded in an unrestricted revenue account.

NNJLS's Controller stated that he does not track expenses by funding source for each case in order to allocate attorney fee revenue received back to the original funding sources. As such, the grantee could not determine the amount that should have been allocated to LSC. Furthermore, NNJLS's Executive Director informed the OIG that the grantee has the capability to allocate expenses associated with each case by funding source; however, the Controller was not utilizing the capability.

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.

While onsite, we found that attorneys' fees were not allocated to LSC in accordance with the meaning of 45 CFR § 1609.4, and the OIG had no way to determine the exact amount that should have been allocated to LSC. After our site visit, grantee management determined that 27.9 percent of attorneys' salaries associated with the cases for which attorneys' fees were received were allocated to LSC. As a result, $10,766 (27.9 percent of $38,587) should have been allocated to LSC. The OIG is questioning $10,766 of attorneys' fees income. The OIG will refer the questioned attorneys' fees to LSC management for review and action.

Interest Income

During the audit period, NNJLS earned $1,331 in interest income. It was all allocated to the unrestricted fund. NNJLS's Controller stated that he allocated all interest income to the unrestricted fund because the amount earned was minimal.

This method of allocating interest income does not comply with 45 CFR §1630.12 which stipulates that derivative income should be allocated to LSC" in the same proportion that the amount of Corporation funds expended bears to the total amount expended by the recipient to support the activity."

According to NNJLS's audited financial statements for the fiscal year-ended June 30, 2013, funding from LSC represented 25.9 percent of total funding. Using this methodology, the OIG estimates that approximately $345 (25.9 percent of $1,331) of interest should have been allocated to LSC.

Properly recording interest income ensures that LSC is apportioned its fair share of income to be used to provide services to LSC eligible clients.

Rental Income

NNJLS did not allocate the correct amount of rental income received from its rental properties to LSC. NNJLS earned $44,000 in rental income during the period under review from leasing office space at its Jersey City building. Of the total rental income earned during the audit period, $36,349 was allocated to the unrestricted fund. The remaining $7,651 was allocated to LSC in response to a recommendation from the Legal Services Corporation's Office of Compliance and Enforcement as a result of their February 2014 visit. The amount allocated to LSC was based on the fact that LSC paid 17.4 percent or $133,165 of the total lease and occupancy costs of $765,772 for the property. The OIG found, however, that NNJLS's Controller reallocated $22,500 in condo maintenance expenses for the property to LSC from IOLTA on June 30, 2014 and did not factor the reclassified expenses into the calculation to adjust derivative income owed to LSC. As a result of the adjustment, LSC actually paid 20.3 percent of the total expenses for the property since the inception of the lease and should have been allocated $8,932 in income rather than $7,651, a difference of $1,281.

In addition, NNJLS earned rental income of $121,908 during the audit period from subleasing a portion of the space at its Hackensack office. The grantee used LSC funds to pay rent and occupancy expenses for the Hackensack office, but did not allocate rental income back to LSC. The grantee did not take into account the fact that NNJLS pays occupancy costs for the entirety of the Hackensack office, a portion of which are allocated to LSC. As a result, the grantee did not appropriately allocate a proportional amount of income to LSC.

For the Hackensack office, the total lease expense, parking, utilities, and security during the audit period was $287,780. In total, LSC paid 34.2 percent of the total lease and occupancy costs for the entire office space, including expenses for the portion of the building that is subleased. As a result, the OIG estimates that approximately $41,693 (34.2 percent of $121,908) in rental income earned on that property should have been allocated back to LSC. Therefore, the LSC OIG is questioning $42,986 of rental income; this includes $1,293 for the space rented to a tenant at the Jersey City office and $41,693 for the sublease of office space at the Hackensack office. The OIG will refer the questioned rental income to LSC management for review and action.

Properly recording derivative income allows LSC to be allocated its apportioned share, which in turn can be used to provide legal services in accordance with LSC requirements.

Recommendations:

Recommendation 3: The Controller should facilitate allocation of derivative income in proportion to funds expended to support each case by tracking expenditures associated with the case by funding source.

Recommendation 4: The Executive Director should ensure that NNJLS adopts and abides by its revised derivative income policy and allocates derivative income back to the revenue source to which the expense that generated the income was allocated.

COST ALLOCATION

The OIG reviewed NNJLS's cost allocation practices and found that the Controller adjusted allocation formulas for a variety of expense types over the audit period, but did not retain sufficient records of the prior distribution percentages. As a result, the OIG could not easily test the formulas. In addition, NNJLS's written cost allocation policy did not address allocation of direct and indirect salary and wage expenses in sufficient detail.

Adjustment of Distribution Codes

As stated, NNJLS did not retain sufficient records of the cost allocation formulas used during the audit period. NNJLS allocates certain types of expenses between funding sources using formulas, called distribution codes, established by the Controller and programmed into the accounting information system. The distribution codes are based, for the most part, on budgeted revenues and are set at the beginning of each fiscal year. Throughout the year, the distribution codes may be revised if, for example, actual revenues vary significantly from projected revenues or for other reasons deemed necessary by the Controller.

The LSC OIG performed detailed testing of cost allocation by examining supporting documentation for five transactions, tracing the transactions to the accounting records and examining the manner in which they were allocated. In our testing, we determined that the allocation formulas for three of the five transactions did not match pre-set distribution codes in the accounting information system.

NNJLS's Controller explained that he revised the distribution codes after the expenses were allocated. Rather than update the allocation scheme with new codes, he overrode existing codes. As a result, the OIG could not trace the allocation of the three transactions to prior codes the Controller used to allocate them.

LSC Grant Assurances for calendar year 2013 and 2014 funding stipulate that grantees must maintain original (or digital images of) financial records and supporting documentation for LSC to audit and determine whether the costs incurred and billed are reasonable, allowable, and necessary under the terms of the grant. In addition, Section 2-5, Accounting Records, in the Accounting Guide states that a grantee's accounting records should provide an adequate audit trail for all transactions.

Allocation of Direct and Indirect Salary and Wage Expenses

NNJLS's cost allocation practices for payroll expenses complied with its written policy; however, the policy is too general and does not address in sufficient detail the procedures for allocating direct and indirect salary and wage expenses.

We performed testing of NNJLS's method of allocating salaries to determine whether it was reasonable and complied with LSC regulations and the grantee's own written policies. NNJLS's actual cost allocation procedure for payroll expenses was reasonable and complied with LSC regulations and with its own written policies. However, NNJLS's cost allocation policies describe the allocation methodology, including payroll expenses, at a high-level, allowing for managerial discretion regarding the manner in which payroll expenses are allocated. In practice, there are nuances in the manner in which salary expenses are allocated based on the source funding the expenses. The grantee's written policies do not include sufficient detail describing the differences in the manner in which salary expenses are allocated, based on funding source or the various processes for allocation.

While the overall methodology appears reasonable, in writing and in practice, a more specific policy would ensure that procedures are repeatable, even in the absence of experienced accounting staff familiar with NNJLS's practices. 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.

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* contained in the LSC Accounting Guide, which require that financial controls be established to safeguard program resources. The Accounting Guide also states 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.

Recommendations: The Executive Director should:

Recommendation 5: instruct the Controller to create new distribution codes rather than overriding pre-existing codes to ensure that a historical record of cost allocation formulas is retained and the allocation methodology is documented in sufficient detail.

Recommendation 6: ensure that all cost allocation processes, as practiced by the grantee, are fully documented in writing, including the manner in which direct and indirect salaries and wages are allocated between funding sources.

DISBURSEMENTS

In our testing of disbursements, the OIG found that transactions were generally in compliance with LSC regulations, adequately supported and appropriately approved. However, the grantee's written policies regarding disbursements need enhancement.

Section 3-5.4, Cash Disbursement, Managing Purchases, of the Accounting Guide states that approvals should be required at an appropriate level of management before a commitment of resources is made and states that criteria for purchases should be documented along with appropriate procedures.

NNJLS's Procedures Guide does not include policies regarding purchase approvals. In interviews, accounting staff told the OIG that the Executive Director reviewed and approved every purchase and the Controller reviewed transactions initiated by the Executive Director. In our review of disbursement transactions, the OIG verified that transactions were reviewed and approved and only noted one exception. The Executive Director acknowledged the need for enhancements to written policies and began drafting revised policies while the OIG was onsite.

NNJLS's written purchasing procedures do not require the use of purchase orders when procuring goods or services that are of a high-dollar value. Implementing a purchasing process that utilizes purchase orders would help the grantee ensure that appropriate approvals are obtained and documented for each purchase. Adhering to a purchase order system helps ensure that goods are approved before ordered, purchases are adequately supported, and grantee funds are used only for their intended purpose.

Recommendations: The Executive Director should:

> Recommendation 7: establish written policies and procedures for approving purchases. The policies should outline the appropriate level of management that must approve purchases before a commitment of resources is made. The grantee should consider using purchase orders to facilitate the purchasing process and to ensure that approvals are required at an appropriate level of management.

FIXED ASSETS

The OIG reviewed the grantee's internal controls over fixed assets and determined they were generally in accordance with the *Fundamental Criteria*. However, the grantee's written policy regarding the frequency of physical inventories needs to be updated as grantee staff did not retain sufficient hardcopy evidence of the inventory.

NNJLS's written policies state that the grantee will perform property inventories at least once per year and more often when warranted. The grantee conducts a physical inventory every two years. This practice is in accordance with the *Fundamental Criteria*, but should also be reflected in NNJLS's written policies to ensure consistency in its application. The cause of the discrepancy was described as a management oversight.

Grantee staff keeps detailed property records and was able to provide evidence of the most recent physical inventory, but staff advised they do not retain hardcopy evidence of prior years' physical inventories because they felt the listing of assets, which is updated at the time of each inventory, was sufficient.

Maintaining records pertaining to prior years' inventories would enhance controls over property.

Recommendations: The Executive Director should:

> Recommendation 8: ensure that the written policy on conducting physical inventories matches the actual practice and that grantee staff retains adequate evidence of physical inventories.

SEGREGATION OF DUTIES

The OIG found that duties related to maintenance of the master vendor list and payroll administration were not adequately segregated.

Master Vendor List

Controls over master vendor list maintenance are lacking and need to be strengthened. The Bookkeeper, who has accounts payable duties that include initiating and processing payments, has primary responsibility for creating new vendors and the ability to edit vendor information in the accounting information system. She can create and change vendor information without prior approval from management. As established, this process could result in unauthorized vendors being set up to receive payments or address changes resulting in payments sent to incorrect locations. Grantee management felt that the Executive Director's review of all disbursements served as an adequate mitigating control.

Approving vendors appropriately and controlling access to the vendor master list helps to ensure that only authorized and approved vendors are paid.

In addition, NNJLS does not have written polices or a formalized process in place for establishing, vetting and approving new vendors. New vendors are created in the system by the Bookkeeper or Controller. The Executive Director reviews and authorizes purchases, which grantee management believed was a sufficient control, but does not formally approve new vendors before they are set up in the accounting system. Establishing a formal vendor approval process, including securing business references and management approval of new vendors, would help ensure that NNJLS engages in business with authorized and legitimate entities.

Payroll Administration

NNJLS's Bookkeeper serves as human resources administrator and is involved in the payroll process. Although the grantee outsources the payroll function to a third party provider, the Bookkeeper has access rights to NNJLS's accounting system that allows her to change salary and wage rate information. The Board of Directors and Executive Director approve all salary and wage rate changes. The Executive Director notifies the Bookkeeper who, in turn, makes the changes in the grantee's automated human resource system. Although a system for review of salary and wage rate changes is in place, we found an instance where the Executive Director authorized a change in the Bookkeeper's salary and she was instructed to make the change herself.

Grantee management believed the approval process in place, whereby the Executive Director instructs the Bookkeeper to make changes to pay rates, provided sufficient internal control.

Section 3-4, Internal Control Structure, Segregation of Duties, of the Accounting Guide provides that accounting duties should be segregated to ensure no individual simultaneously has both the physical control and the record-keeping responsibility for any asset. Duties must be segregated so no individual can initiate, execute and record a transaction without a second independent individual being involved in the process.

Recommendations: The Executive Director should:

Recommendation 9: establish and adhere to written policies for securing and approving new vendors. These policies should outline procedures for setting up new vendors in the accounting information system to ensure that only employees independent of the accounts payable function are allowed to create new vendors and edit vendor information.

Recommendation 10: ensure that duties related to payroll and human resources administration are adequately segregated or, where full segregation of duties is impracticable, ensure that appropriate controls, such as management involvement, are in place to mitigate the risk.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with all 10 recommendations contained in the report.

Grantee management stated that purchasing policies had been revised in October 2014 to specify the threshold amount for requiring competitive bids, the number of bids to be obtained, the frequency of such bidding, the waiver of bidding requirements for good cause, the approval of contracts by the Executive Director and the thresholds for notification of the Board of Directors regarding contracts and bidding. Grantee management will propose policy changes to the Board regarding procedures for sole source contracting. NNJLS also established a centralized contract filing system.

NNJLS revised its derivative income policy as of October 2014 and will propose further revisions of the policy to the Board of Directors to require tracking of expenditures by case. The Executive Director and Controller will periodically review derivative income received by the program to ensure it is allocated to the proper revenue source. Grantee management agreed that $41,693 of rental income for the Hackensack office should be credited to LSC. NNJLS also agreed that $1,282 in rental income for the Jersey City office and $345 in interest income should be allocated to LSC. Grantee management calculated the percentage of attorneys' salaries allocated to LSC for cases for which SSI reimbursements and attorneys' fees were received. During the audit period, 27.9% of attorney's salaries for associated cases were allocated to LSC, therefore grantee management determined that $18,487 (27.9 percent of $66,263) should be allocated to LSC for SSI reimbursement and $10,766 (27.9 percent of $38,587) should be allocated to LSC for attorney's fees income. The total derivative income to be allocated to LSC is $72,572.

NNJLS has discontinued the practice of overwriting old and obsolete distribution codes. NNJLS will include additional detail in its salary and wage allocation policy to reflect the varying requirements of funding sources.

Grantee management will revise NNJLS's purchasing policy and will consider using a purchase order system. The Executive Director will continue to approve all purchases. Grantee management will amend its policy regarding the frequency of physical inventories and require that they be conducted every two years and ensure that hard copies of prior inventories are maintained.

NNJLS is amending its policies to require authorization from the Executive Director prior to adding vendors to the master vendor list. The Executive Director will continue to approve all purchases in advance. Grantee management will ensure that management controls remain in place so no one employee can initiate, execute and record a transaction. The grantee will also maintain central files regarding contracting and bidding processes.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS –

The OIG considers the proposed actions to address all Recommendations in the report as responsive. Recommendations 1, 3, 4, 6, 7, 8 and 9 will remain open until NNJLS's Board of Directors approves the revised policies and the OIG receives written notification that the policies have been approved and implemented.

The OIG accepts grantee management's calculation of the amount of SSI reimbursements and attorneys' fees that should have been allocated to LSC. Based on information provided by grantee management and accepted by the OIG, the total derivative income that should be allocated to LSC is $72,572. This amount will be referred to LSC management.

Since the actions implemented have fully addressed Recommendations 2, 5 and 10, we consider them closed.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Salary Advances,
- Cash Disbursements,
- Contracting,
- Credit cards,
- Property and Equipment,
- Internal Management Reporting and Budgeting,
- General Ledger and Financial Controls,
- Derivative income,
- Client trust funds, and
- Cost Allocation.

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 the grantee provided 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 existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample consisted of 98 disbursements totaling $279,018.10. The sample represented approximately 4 percent of the $6,539,348.71 disbursed for expenses other than payroll during the period January 1, 2013 to June 30, 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 process for the scope period with grantee management and requested the grantee's written cost allocation policies and procedures for review 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.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the grantee's Procedures Guide. We interviewed appropriate program personnel and performed recalculations of some revenue accounts.

The on-site fieldwork was conducted from September 8 to 12 and September 17 to 19, 2014. Our work was conducted at the grantee's office in Jersey City, NJ and at LSC headquarters in Washington, DC. We reviewed documents pertaining primarily to the period January 1, 2013 through June 30, 2014.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that 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.

Northeast New Jersey Legal Services, Inc.
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March 20, 2015

Mr. John M. Seeba
Assistant Inspector General for Audit
Office of the Inspector General
Legal Services Corporation
3333K Street, NW, 3rd Floor
Washington, DC 20007-3558

Dear Mr. Seeba

We have received your draft monitoring report and want to thank you for your recommendations. We have reviewed them and agree to make the changes to our financial procedures that you suggest. As the report correctly states, NNJLS had already made many of the changes and we anticipate completing the remainder in the near future.

While agreeing to adopt your suggestions, we are also submitting comments regarding some of the findings. LSC's recommendations are listed first followed by our response to the recommendations and then our comments.

Contracts

Recommendation 1: enhance and revise existing written policies regarding contracting to ensure that they address the elements required by the *Fundamental Criteria* including contracting procedures for different types of contracts, competition, documentation and approval requirements. The policies should include procedures for deviating from the approved contracting process, such as when the grantee decides to execute sole-source contracts.

Recommendation 2: ensure that a centralized contract filing system is created whereby each contract file relates to a specific contract and contains all pertinent documentary support related to the contract action, including the contract document, solicitation, receipt and evaluation of bids and the award of the contract.

Response: Effective October 22, 2014 NNJLS revised its purchasing policies to add specificity regarding the threshold amount for requiring competitive bids, the number of bids to be obtained, the frequency of such bidding, the waiver of biding requirements for good cause, the approval of contracts by the Executive Director and the thresholds for notification of the Board of Directors regarding contracts and biding. NNJLS updated its Financial Policies and Procedures Guide in 2013 to add specific sections addressing legal consultants and contract services as well as capital expenditures. See the attached NNJLS Policies. In response to LSC's comments, NNJLS has also established a central file for maintaining all relevant documentation regarding contracting and bidding. In addition, we will also propose policy changes to the Board regarding establishing additional procedures for sole source contracts.

Comments: We note that NNJLS has at all times exercised rigorous oversight over all financial procedures. Purchasing procedures, the issue addressed by LSC, are one example. The Director personally approves all purchases in advance after assuring that the financial team has conducted due diligence in obtaining the best price from a variety of reputable vendors. While NNJLS has agreed to revise its purchasing policy, even under the prior procedures NNJLS diligently obtained the best possible prices from the most reputable vendors

In making recommendations, the audit report states that eight of the nine contracts reviewed were not subject to competitive bidding. However, it is important to take into consideration the circumstances surrounding the retention of each vendor. Of the eight contracts referred to in the draft report, one was for the renewal of an office lease, one was for a second office lease, one was a listing agreement with a real estate broker for office space, one was for postage meters, one for a payroll service, two were for cleaning services, and one for a contract for repairs needed in order to sublet office space. It is important to note that in each case NNJLS actively worked to investigate alternatives and obtain the best price. This included aggressively negotiating lower rental costs for the two leases which included visiting and comparing costs for other rental properties in the area. NNJLS also thoroughly investigated the cost of comparable postage meters and the payroll service, although not within the time period covered by the audit. In addition, although NNJLS did not have current contracts with the two janitorial services and had not obtained competitive bids in recent years, neither vendor has raised their price in over ten years. In addition, NNJLS believes that not having a contract for a specific term with each vendor works to NNJLS's benefit as it allows for the immediate termination of the vendor at NNJLS's option. It is also important to note that the real estate broker charged the same fee for his service as other brokers in the area and the cost of both the payroll service and the office repairs were below the $5,000 threshold above which NNJLS policies require a contract and competitive bidding.

The report also states that two contracts were not in writing and one was not approved by the Executive Director. These comments relate to the two janitorial vendors mentioned above and, for the reasons stated above, NNJLS asserts that written contracts with these vendors would not be appropriate. However, NNJLS acknowledges that periodically obtaining competitive bids for these services is advisable. In addition, the report states that sole source justification and documentation was not adequate. As stated, NNJLS agrees and is revising its policies to require better documentation for competitive bidding and sole source vendor decisions.

Derivative Income

Recommendation 3: The Controller should facilitate allocation of derivative income in proportion to funds expended to support each case by tracking expenditures associated with the case by funding source.

Recommendation 4: The Executive Director should ensure that NNJLS adopts and abides by its revised derivative income policy and allocates derivative income back to the revenue source to which the expense that generated the income was allocated.

Response: NNJLS revised its derivative income policy effective October 22, 2014 in response to comments from LSC. We will propose further revisions of the policy to our Board which will require the tracking of expenditures by case when feasible. The Director and Controller will also periodically review derivative income received by the program in order to make sure that it is allocated to the proper revenue source.

Comments: The draft report correctly notes that NNJLS has revised its Financial Policies and Procedures Guide regarding derivative income in order to assure that program income is allocated to LSC if appropriate. In this regard NNJLS agrees that $41,693 of rental income for the sublet of the Hackensack office should be credited to LSC. NNJLS also agrees that $345 in interest income and $1,281 in rental income for the Jersey City office during the period in question should be allocated to LSC.

Regarding court awarded attorney fees and Supplemental Security Income reimbursement (SSI); we assert that the income should be allocated to LSC in the same proportion as attorney's salary was allocated to LSC since the costs were not directly charged to a funding source. During the period in question 27.9% of attorney's salary was allocated to LSC. Based on this, the amounts to be allocated to LSC for SSI and attorney's fees income should be $18,487and $10,766 respectively.

As a result, we assert that a total of $72,572 should be allocated to LSC during this period as derivative income. In this regard it is important to note that had the allocation been made in the applicable fiscal year it would not have caused NNJLS to exceed its permissible fund balance.

Cost Allocation

The LSC report states that the Executive Director should:

Recommendation 5: instruct the Controller to create new distribution codes rather than overriding pre-existing codes to ensure that a historical record of cost allocation formulas is retained and the allocation methodology is documented in sufficient detail.

Recommendation 6: ensure that all cost allocation processes as practiced by the grantee are fully documented in writing, including the manner in which direct and indirect salaries and wages are allocated between funding sources.

Response: NNJLS has discontinued the practice of overwriting older and obsolete distribution codes. NNJLS also agrees to include additional detail in its salary and wage allocation policy in order to reflect the varying requirements of funding sources.

Disbursements

The LSC report states that the Executive Director should:

Recommendation 7: establish written policies and procedures for approving purchases. The policies should outline the appropriate level of management that must approve purchases before a commitment of resources is made. The grantee should consider using purchase orders to facilitate the purchasing process and to ensure that approvals are required at an appropriate level of management.

Response: NNJLS has agreed to revise its purchasing policy to add more specificity and will also continue the practice of having the Director approve all purchases. NNJLS also agrees to consider using a purchase order system.

Fixed Assets

The LSC report states that the Executive Director should:

Recommendation 8: ensure that the written policy on conducting physical inventories matches the actual practice and that grantee staff retains adequate evidence of physical inventories.

Response: NNJLS agrees that a fixed asset inventory need only be conducted every two years and is amending its policy accordingly. In addition, NNJLS will assure that hard copies of prior inventories are maintained.

Segregation of Duties

The LSC report states that the Executive Director should:

Recommendation 9: establish and adhere to written policies for securing and approving new vendors. These policies should outline procedures for setting up new vendors in the accounting information system to ensure that only employees independent of the accounts payable function are allowed to create new vendors and edit vendor information.

Recommendation 10: ensure that the duties related to payroll and human resources administration are adequately segregated or, where full segregation of duties is impracticable, ensure that appropriate controls, such as management involvement, are in place to mitigate the risk.

Response: In addition to continuing the current practice of having the Director approve all purchases in advance, NNJLS is amending its policies to require authorization from the Director prior to adding a new vendor to the master vendor list. NNJLS will also maintain a central file documenting the contracting and bidding process as well as records justifying purchases which are made without bidding. NNJLS will also assure that management controls remain in place which will assure that no one employee can initiate, execute and record a transaction without the approval of the Director and without review by the Bookkeeper and Controller.

Thank you for considering our response to LSC's draft report. If you have any questions or require any additional documentation please do not hesitate to contact us.

Sincerely,

John H. Fitzgerald, Esq.
Executive Director

NNJLS Financial Procedures Guide
Insert on page 31

PURCHASING

The Bookkeeper, Office Managers and Program Manager will ensure that all goods and services are purchased at the lowest possible cost. If circumstances warrant paying a higher cost, the reasons for doing so shall be clearly documented.

Competitive bids will be obtained for goods and services which exceed $5,000 for any single purchase or for multiple purchases from a particular vendor which will exceed $5,000 in a fiscal year. If the purchase of goods and services from a particular vendor is re-occurring, competitive bids must be obtained at least once every three years. At least three bids should be solicited when obtaining competitive bids. If good cause is present, the competitive bidding requirements may be waived with the approval of the Executive Director. The reasons for waiving the competitive bidding requirement must be clearly documented and must be reported to the NNJLS Board of Directors Finance Committee at its next meeting or, in the case of re-occurring expenditures, once per year.

Contracts must be executed for the purchase of goods or services in excess of $5,000 or which will exceed $5,000 for a particular vendor in a single fiscal year. The requirement that contracts be executed for such purchases may be waived by the Executive Director for good cause. If the contract requirement is waived, the reasons for doing so shall be clearly documented and the waiver reported to the Finance Committee at its next meeting or, in the case of reoccurring expenditures, once per year.

NNJLS Financial Procedures guide
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CAPITAL EXPENDITURES

Expenditures for real and personal property in excess of $5,000 will be capitalized, tagged, inventoried and depreciated. Real Property purchases represent those purchases of buildings and land. Personal Property expenditures represent purchases of computer software and hardware, other equipment, furniture and improvements to leased and owned property.

All expenditures for capital additions must be competitively priced prior to approval and ordering. The person purchasing the item is required to obtain telephone quotes for all purchases under $5,000 and written quotes for all purchases in excess of $5,000. Vendor selection will depend upon quality and service as well as price. The Executive Director must approve the final selection after reviewing the recommendations and proposals.

Capital expenditures may be charged to the Legal Services Corporation, however, any purchase of equipment or furniture in excess of $10,000 (for a single item) or any purchase of Real Property requires prior approval from the Corporation. NNJLS may charge a portion of an asset to LSC funds and the balance to another funding source without prior approval from the Corporation.

All capital additions will be tagged and inventoried according to the Capital Assets policies and procedures in this Guide.

NNJLS Financial Procedures Guide
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LEGAL CONSULTANTS AND CONTRACT SERVICES

A properly executed contract for consulting services must be approved and signed by the Executive Director for all services rendered to NNJLS. Services in this category include, but are not limited to: legal, accounting, Private Attorney Involvement or investigation. A properly executed contract must include the signature of the Executive Director as well as the description of work to be performed, dates of employment and amount to be paid. If necessary, approval from funding source will be obtained prior to entering into contract.

Audit contracts will be submitted on an approved in compliance with LSC regulations outlined in the LSC Accounting and Audit guides.

Contractors invoice must be completed and approved by the appropriate individual before payment can be made to the Contractor. The Controller will be responsible for monitoring cost to ensure that they incurred within the appropriate fiscal year and do not exceed budget authority. Also, assuring that invoices are within the contract limits and reporting to the Executive Director when contract limits are near or will be exceeded with the current invoice.

The Executive Director will initiate a Contract for Service. The contract must include the following data:

- Contractor Name
- Social Security Number or EIN number
- Description of work to be performed
- Rate of pay
- Period for which work will be performed
- Maximum amount of contract
- Contractor signature

Once complete, the contract must be forwarded to the Executive Director for review and approval. The contract must then be signed by the Executive Director. If necessary, the contract is forwarded to the funding source for approval by the Grant Manager. Only after all approvals and signatures have been obtained, may the contractor commence work. A copy of the contract is forwarded to the Controller.

An invoice from the contractor must be submitted before payment can be made. The following information must be included on the Contractor's invoice:

- Name and Address of Contractor
- Date(s) worked
- Description of services
- Days or hours worked
- Rate of Pay
- Total amount due
- Approval by appropriate NNJLS staff member

The approved invoice is forwarded to the Controller for review and payment. The Controller reviews the contract and invoices to assure that total payments do not exceed the maximum amount stipulated in the contract. If the invoice exceeds the total contract amount, an amendment to the contract will be required along with the Executive Director approval before payment can be made. If travel expenses or other miscellaneous expenses are included in the contract, those expenses must be itemized on the Contractor invoices and appropriate receipts must be attached.