Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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May 15, 2014

Mr. Anthony L. Young
Executive Director
Southern Arizona Legal Aid, Inc.
2343 East Broadway, Suite 200
Tucson, AZ 85719

Dear Mr. Young:

Enclosed is the Office of Inspector General's (OIG) final report for our audit of Selected Internal Controls at Southern Arizona Legal Aid, 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.

Management accepted Recommendation 1, and included additional analysis and comments to clarify how each category of funding is allocated its share of the total cost based upon the revenue received. This recommendation is considered closed. The OIG considers the proposed actions to address Recommendations 2, 3, 4, 5 and 6 as responsive. However, all five will remain open until the OIG is notified in writing that the proposed action has been completed or implemented.

The original report included a questioned cost amount of $1,058.67 on pages 5 and 6. Based on information provided by grantee management and accepted by the OIG, the correct questioned cost amount is $559.48 and is the amount that will be referred to LSC management. Therefore, the audit report has been revised to correct the total amount questioned.

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

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

FINAL REPORT ON SELECTED INTERNAL CONTROLS

SOUTHERN ARIZONA LEGAL AID, INC.
RNO 703050

Report No. AU14-04

May 2014

www.oig.lsc.gov

INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Southern Arizona Legal Aid ("SALA" or "grantee") related to specific grantee operations and oversight. Audit work was conducted at the grantee's main office in Tucson, Arizona and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2011 through November 28, 2012.

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

According to its website, SALA was incorporated in 1951. Over the years, several of the area's small legal aid providers merged with the program which retained the staff and local office names. The main office is in Tucson. The program also has offices in Bisbee, Nogales, Casa Grande, Sacaton, Whiteriver, and Lakeside. These offices have three to four staff members each.

According to the audited financial statements for the grantee's fiscal year ended December 31, 2011, the grantee received $2,778,823 from LSC and $1,062,349 from other government contracts.

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.

OVERALL EVALUATION

While many of the controls were adequately designed and properly implemented as the controls related to specific grantee operations and oversight, some controls need to be strengthened and formalized in writing. The grantee needs to place more emphasis on establishing and documenting some internal controls.

In general, grantee disbursements tested were adequately supported and allowable. However, we found some disbursements that were unallowable. Three[1] instances were noted where the grantee used LSC funds to buy flowers and make donations in lieu of flowers for occasions that appeared to be personal life events of employees of a non-business nature.

Internal controls over employee benefits and reimbursements were generally adequate. Policies over employee benefits were in writing. The grantee's policy does not allow for salary advances to employees and no salary advances were identified in our testing.

The grantee's current practices involving internal management reporting and budgeting were generally in accordance with the LSC's *Fundamental Criteria*.

In our opinion, the cost allocation system, as implemented, was not in accordance with LSC regulations. SALA employed a cost allocation system that allocated most allowable indirect costs to the LSC grant and much less of the indirect costs to most other non-LSC funding sources. LSC provides an exception for "certain indirect costs," from being divided by an equitable distribution base and distributed to individual grant awards accordingly. When funding sources refuse to allow the allocation of certain indirect costs to an award, the LSC recipient may allocate a proportional share of that funding source's share of an allowable indirect cost to LSC funds. SALA was bidding on non-LSC grants using reduced indirect costs. The amount that indirect costs were reduced was then charged to LSC funds. Since the funding source did not refuse to allow SALA to allocate certain indirect costs but merely accepted SALA's proposal, we do not believe the exception to the regulation was met.

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[1] The originally issued report did not include the revised amount provided by grantee management and agreed to by the OIG.

Other issues noted include the need to:

- Document and follow policies and procedures to allocate attorneys' fees and other derivative income. The program received attorneys' fees during the period under review and two instances were noted where the attorneys' fees were not correctly allocated to LSC;

- Fully develop and document policies and procedures relating to soliciting and awarding contracts;

- Strengthen documented procedures of the cost allocation system, as the cost allocation process was not adequately documented.

AUDIT FINDINGS

COST ALLOCATION SYSTEM

In our opinion, SALA's cost allocation system was not in compliance with LSC regulation 45 CFR, Part 1630, Cost Standards and Procedures. SALA employed a cost allocation system that allocated most allowable indirect costs to the LSC grant and much less of the indirect costs to most other non-LSC funding sources.

When only one major function is performed by a grantee, LSC allows a simplified allocation method to be used by the grantee "whereby total allowable indirect costs (net of applicable credits) are divided by an equitable distribution base and distributed to individual grant awards accordingly." 45 CFR § 1630.3(f). This is, in fact, the preferred method, "[g]enerally, recipients should use an indirect cost allocation method which distributes costs equitably among all funding sources." 62 Fed. Reg. 68219, 68222 (Dec. 31, 1997). Part 1630 provides an exception for "certain indirect costs," when funding sources "refuse to allow the allocation of certain indirect costs to an award." 45 CFR § 1630.3(g). In those cases, "a recipient may allocate a proportional share of another funding source's share of an indirect cost to Corporation funds, provided that the activity associated with the indirect cost is permissible under the LSC Act and regulations."[2] When the Corporation added section 1630.3(g) to the regulation in 1997, it made clear that this exception only applied where the other funding sources did not permit or would not allow the charging of the indirect costs.[3] See 62 Fed. Reg. 45778, 45779 (August 29, 1997) and 62 Fed. Reg. 68219, 68222. Thus, LSC permits

[2] It is unclear from the regulation, however, if, when it allowed allocation of "certain indirect costs" to LSC funds, LSC contemplated charging all or almost all allowable indirect costs associated with a non-LSC grant to LSC funds.

[3] Prior to the revision in 1997, Part 1630 allowed the allocation of overhead to LSC funds where the non-LSC funding source "did not provide for overhead." 51 Fed. Reg. 29076, 29077 (August 13, 1986). The regulation promulgated in 1986 did not contain a specific provision to this effect; the interpretation appears solely in the supplementary information accompanying the regulation's publication. As mentioned, when the Corporation added a provision to the regulation in 1997, it narrowed the restriction.

grantees to allocate a proportional share of another funding source's share of an allowable indirect cost to Corporation funds if the funding source refuses to allow the allocation of certain indirect costs. 45 CFR§ 1630.3(g).

SALA employed a cost allocation system that allocated most allowable indirect costs as costs to the LSC. SALA management believed they received funding from non-LSC sources because the overhead rate (indirect costs) used to apply for those grants was low. We could not verify that the grants were awarded based on the overhead rate, but understand that some funders consider the size of the overhead burden in making funding decisions.

The language of the regulation appears to require an affirmative act on the part of the other grantor, *i.e.*, refusing to allow the allocation. If a grantee voluntarily provides a low indirect cost rate when applying for a grant, this does not seem to constitute a refusal by the funding source to allow the allocation of certain indirect costs. Rather than allocating most indirect costs to the LSC grant, the allowed indirect costs incurred by the grantee should have been divided by an equitable distribution base and distributed to individual grant awards accordingly.

Allocating all or most indirect costs to LSC funds for LSC-eligible cases funded by non-LSC funders may result in fewer LSC-eligible clients receiving service. For instance, if a non-LSC funder allows its grant funds to be used for clients who exceed LSC income requirements, then the amount of indirect costs associated with the non-LSC grant but allocated to LSC funds would be available to be used to provide service to those clients who were not LSC eligible. Because LSC would have higher indirect costs and less direct funds to serve LSC eligible clients, LSC funds could be subsidizing service to LSC-ineligible clients.

Even if the grantee only provided service to LSC-eligible clients, we do not believe a system that charges all or most indirect costs to LSC funds is in compliance with the regulation without the specific refusal of non-LSC funders to permit the allocation of certain indirect costs. This practice, when looking at LSC funds in isolation, may give stakeholders an incorrect view as to how LSC funds are used and managed. Specifically, when looking at SALA's audited financial statement supplemental information for fiscal years 2011 and 2012, the percent of funds charged to LSC for lawyers' salaries is 17 percent for each year compared to the per cent charged to "Other government contracts" which was 59 percent and 55 percent respectively.[4] Looking at these percentages may lead LSC stakeholders to believe that LSC funds are not used efficiently and effectively because of the rather limited amount used to provide for lawyers' salaries.

Auditor's Comment. Because we understand it is a relative common practice within the grantee community to apply for non-LSC grants using a reduced

[4] Lawyers' salaries do not include employee benefits. Also, paralegal salaries (which would generally be considered direct costs) were not listed separately in the financial statements and are not used to calculate percentages presented above.

overhead rate which, in our opinion, seems to go beyond the intent of the regulation and we can find no other implementing guidance from LSC, we are forwarding this issue to LSC management for review and clarification.

Recommendation 1: The Executive Director should establish an allocation system that ensures that allowable indirect costs (net of applicable credits) are divided by an equitable distribution base and distributed to individual grant awards accordingly.

PROHIBITED PURCHASES

For the most part, disbursements tested were adequately supported and allowable. However, \$559.48[5] of unallowable expenses was charged to LSC funds for flower donations and flower purchases for occasions that appeared to be personal life events of employees of a non-business nature.

The grantee used LSC funds to purchase flowers on two occasions to recognize employees for administrative professionals' day, on another occasion for an employee departing the organization and on two occasions for employees experiencing personal life events.

According to the grantee, they were not aware that such expenses were unallowable under the LSC grant. Also, the SALA Accounting Manual did not include a section on unallowable expenses. LSC regulation 45 CFR, Part 1630, Cost Standards and Procedures, § 1630.3, states in part the recipient must demonstrate that an expenditure is reasonable and necessary for the performance of the grant or contract as approved by LSC.

Ensuring allowable costs for disbursements helps to affirm that funds are only used for authorized purposes. Because the three[6] disbursements identified are unallowable within the meaning of 45 CFR §1630.3, the OIG is questioning \$559.48, the total value of the three[5] disbursements. The OIG will refer the questioned costs to LSC management for review and action.

Recommendation 2: The Executive Director should include in SALA's Accounting Manual policies and procedures the prohibition to use LSC funds for unallowable expenses including, but not limited to, the purchase of flowers, donations in lieu of flowers, holiday parties, alcohol purchases, late fees or finance charges. These policies should be briefed to all grantee staff, emphasizing that LSC's funds are to be used for business purposes only.

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[5] The originally issued report did not include the revised amount provided by grantee management and agreed to by the OIG.

[6] See above footnote.

ATTORNEYS' FEES

SALA did not have written policies and procedures for recording and allocating attorneys' fees or other types of derivative income. Practices described by the grantee for recording and allocating derivative income were in compliance with LSC regulations. However, review of transactions involving attorneys' fees noted that the actual practice used in two instances was not in compliance with LSC regulations or with the practices described by the grantee. For two cases funded with LSC funds, attorneys' fees, in the amount of $1,000 ($500 for each case), were received but not allocated to LSC. SALA allocated the $1,000 in attorney's fees received for these two cases to its general fund rather than to LSC funds.

LSC Regulation 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.

According to the Chief Financial Officer, the grantee is aware of the LSC regulation for allocating attorneys' fees, but stated that the two instances where attorneys' fees were not allocated to LSC funds were due to oversight. Properly recording derivative income ensures that LSC is apportioned its fair share of income to be used for LSC eligible clients

Because the two attorneys' fees identified are not properly recorded within the meaning of 45 CFR §1609.4, the OIG is questioning $1,000 for those attorneys' fees. The OIG will refer the questioned costs to LSC management for review and action.

Recommendations. The Executive Director should:

> Recommendation 3: formalize in writing policies and procedures for recording and allocating derivative income, including attorneys' fees.
>
> Recommendation 4: ensure that SALA personnel fully implement the requirements of LSC Regulation 45 CFR § 1609.4(a) related to the recording of income derived from attorneys' fees.

DOCUMENTING POLICIES AND PROCEDURES

Operating practices for some areas reviewed were not documented in the grantee's Accounting Manual to comply with the *Fundamental Criteria* contained in the LSC Accounting Guide. The Accounting Manual documents the policies and procedures to be followed by SALA staff in meeting the objectives and criteria of LSC and its other funding sources. The grantee's current practices involving soliciting and awarding contracts and cost allocation generally conformed to the *Fundamental Criteria*.

The Accounting Manual, however, did not detail the written policies and procedures relating to the awarding of contracts and consulting agreements. Grantee's management stated that while there are no written contract and consulting policies, the grantee has a very limited number of contract vendors that they use. The Executive Director approves all the grantee contracts. When a need arises for services that require a contract, the senior management involved sends an informal request to the Executive Director for approval. Depending on the size of the contract, a minimum of two vendors are contacted by the phone to get quotes for the needed services. For small contracts (contracts under $1,000), the vendors issue the grantee verbal quotes. The Executive Director and the manager review the bids together prior to approving the contract.

Subsequent to our grantee field work, the grantee provided a contracting policy that was adopted by the Board in November 2013. We reviewed the contracting policy and determined that the policy generally conformed to the *Fundamental Criteria* except:

- the number of bids required for "competitive bids" was not documented;
- the threshold limit for competitive bids had conflicting amounts within the same policy. Part 3B indicated 'an amount over $25,000' while Part 5A indicated an amount 'costing more than $2,500'; and
- the Executive Director's contract execution limit amount of $100,000 appears to be above a reasonable level.

Also, the cost allocation system was not fully documented. During our audit, the Chief Financial Officer (CFO) provided the OIG with an oral description of the process, but acknowledged that the written description did not sufficiently detail how the grantee allocates cost to its various grants. Grantee management stated they were unaware that some of the procedures needed to be documented in the Accounting Manual.

As part of a robust 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 requires that financial controls be established to safeguard program resources.

An updated and complete accounting manual helps the grantee ensure that proper controls are followed. The accounting manual also serves as a vehicle to communicate controls to all staff and ensures that staff members understand their roles and responsibilities. Without adequate written policies and procedures in place, transactions may be initiated and recorded that violate management intentions, or possibly laws or grant restrictions.

Recommendations. The Executive Director should:

> Recommendation 5: address the following areas in SALA's new contracting policy:
>
> - the number of bids required for "competitive bids";
> - the threshold limit for competitive bids; and
> - a reasonable level for the Executive Directors' contract execution limit amount.
>
> Recommendation 6: develop and incorporate detailed written policies and procedures to document the cost allocation process.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with the findings and recommendations contained in the report. Grantee management stated its Accounting Manual will be updated to address deficient policies and procedures listed in the report. Management submitted copies of policies and procedures which will be presented to SALA's Board of Directors for approval, and then made part of the Accounting Manual. Management also provided the OIG with additional documentation and explanations to support some of the disbursements that the OIG had questioned. Our evaluation of the additional information is discussed below. Management's formal comments can be found in Appendix II. Appendix II does not include the additional supporting documents provided by management.

OIG EVALUATION OF GRANTEE COMMENTS

Management agreed with recommendation 1 and provided additional details on its cost allocation system as described below. This recommendation is considered closed.

The OIG considers grantee management's actions planned to address recommendations 2, 3, 4, 5 and 6 as responsive to the findings and recommendations contained in the report. The actions planned by grantee management to revise and update its Accounting Manual should correct the issues identified on the report. The OIG considers all five recommendations open until notified in writing that the grantee's Accounting Manual has been updated and communicated to SALA staff. However, we do provide the following information for two of management's comments:

Cost Allocation System

Management has accepted recommendation 1 and included additional analysis and comments which state that each category of funding is allocated its share of the total cost based upon the revenue received. In addition, according to Management, LSC's analysis is limited to only attorney salaries, whereas Management believes it's more appropriate to compare the amounts allocated to LSC and other funders as a percentage of the total. Management added that in the future, it will ensure that proposals for funding include applicable overhead costs where allowed by the grantor.

Prohibited Purchases

Management provided evidence that two disbursements totaling $499.19, questioned by the OIG, for purchase of flowers were reversed by general journal entry to non-LSC funds. Because of this evidence, the OIG is no longer questioning the total value of the five disbursements and will reduce the amount referred to LSC management by $499.19. The amount referred to LSC management is $599.48. The originally issued report has been updated to include the revised amount provided by grantee management.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Cash disbursements;
- Contracting;
- Cost Allocation;
- Credit cards;
- Salary Advances;
- Property and Equipment;
- Internal Management Reporting and Budgeting; and
- Derivative Income.

Controls over client trust fund accounting were reviewed, but not tested.

To obtain an understanding of the internal controls over these areas, 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 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 Accounting Guide. We assessed the reliability of computer generated data provided by the grantee by reviewing source documentation for the entries selected for review. We determined that the data were sufficiently reliable for the purposes of this report. This review was limited in scope and was not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

To test controls and the appropriateness of expenditures, we reviewed a judgmentally selected sample of disbursements that included employee and vendor files, and credit card purchases. The sample was taken from the period January 1, 2011, through November 28, 2012, and represented 5.8 percent of the $2,912,959.05 disbursed for expenses other than payroll and comprised 113 disbursements totaling $170,098.36. To assess the appropriateness of expenditures, we reviewed supporting documentation such as invoices and vendor lists, and traced the transactions to general ledger details. Amounts allocated to LSC funds were traced to LSC general ledger accounts. The appropriateness of those expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance.

Controls over employee benefits and salary advances were reviewed by examining the Collective Bargaining Agreement and other personnel policies and practices. To evaluate internal controls over internal management reporting and budgeting, the grantee's system and processes were compared to those detailed in the LSC Accounting Guide.

The cost allocation process was reviewed to determine if the system was operating as designed. We verified amounts allocated to selected grants based on the verbal descriptions of the cost allocation system provided by the grantee. In addition, we compared the cost allocation process actually in use to the written description provided by the grantee to determine if cost allocation process was operating as documented in the grantee's Accounting Manual.

To review controls over contracts, we requested from SALA all contracts and/or agreements involving disbursements that were entered into during 2011 and 2012. We also relied on SALA's Check Register to identify the universe of contracts. A total of eight contractors were identified. We reviewed documentation maintained in contract files and interviewed SALA's management to assess compliance with the LSC *Fundamental Criteria*.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the Accounting Manual. To evaluate controls over client trust fund accounting, we interviewed appropriate program personnel and examined related policies and procedures.

The on-site visit was conducted from November 27, 2012 through December 5, 2012 and June 24, 2013 through June 26, 2013. Audit work was conducted at the grantee's main office in Tucson, Arizona and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2011, through November 28, 2012.

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 that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

APPENDIX II

GRANTEE MANAGEMENT COMMENTS

Pima County

Continental Building
2343 East Broadway Blvd
Suite 200
Tucson AZ 85719-6007
520-623-9465 / 800-640-9465
Fax 520-620-0443

Branches/Divisions

Tohono O'odham Legal Services
2343 East Broadway Blvd
Suite 200
Tucson AZ 85719-6007
520-623-9465 / 800-246-6789
Fax 520-620-0443

Cochise, Graham, Greenlee Counties

400 Arizona Street
Bisbee AZ 85603-1634
520-432-1639 / 800-231-7106
Fax 520-432-1641

Pinal County

766 North Park Avenue
Casa Grande AZ 85122-3031
520-316-8076 / 877-718-8086
Fax 520-316-8055

Four Rivers Indian Legal Services
403 Seed Farm Road
P.O. Box 68
Sacaton AZ 85147-0001
520-562-3369 / 800-312-2290
Fax 520-562-3800

Santa Cruz County

2343 East Broadway Blvd.
Suite 200
Tucson AZ 85719-6007
520-287-9441
Fax 520-287-9285

Apache, Gila, Navajo Counties

White Mountain Legal Aid
Wagon Wheel Plaza
5658 Highway 260 - Suite 15
Lakeside AZ 85929-6160
928-537-8383 / 800-658-7958
Fax 928-537-1838

White Mountain Apache Legal Services
202 East Walnut Street
P.O. Box 1030
Whiteriver AZ 85941-1030
928-338-4845 / 866-312-2291
Fax 928-338-1436

LSC

United Way

Southern Arizona Legal Aid, Inc.

Justice. Opportunity. Hope.

April 30, 2014

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

Re: Response to Draft Report on Selected Internal Controls

Dear Mr. Seeba:

Southern Arizona Legal Aid, Inc. (SALA) received the Office of Inspector General Draft (OIG) Report on Selected Internal Controls dated March 21, 2014. SALA requested an extension of time to submit its comments and Anthony Ramirez, Audit Team Leader, approved our request for an extension until May 1, 2014.

SALA provides its comments herein, including attachments incorporated by reference, associated with the OIG's recommendations and hope they adequately address the issues identified.

COST ALLOCATION PLAN

Recommendation 1. *The Executive Director should establish an allocation system that ensures that allowable indirect costs (net of applicable credits) are divided by an equitable distribution base and distributed to individual grant awards accordingly.*

SALA accepts this recommendation. As noted in the report, grants have been awarded which, in most instances, cover the cost of personnel and not all related overhead costs. While some funders may not refuse to pay for overhead costs, most awards are small or are awarded for specific amounts, far less than necessary to cover project staff, which limit SALA's ability to allocate overhead cost. In an effort to maximize the funding, budgets are developed which allocate the majority of the costs to personnel. Personnel costs represent 75% of SALA expenses. Federal awards do not allow indirect costs to be allocated without an approved indirect cost rate, which SALA does not currently have.

SALA has some grants and contracts which only pay for personnel costs, mainly small grants under $30,000. For example, SALA's HUD Housing Counseling grant supports only staff providing housing counseling services, and SALA's Gila River Indian Community grant supports only the staff in SALA's Sacaton office by Tribal resolution. In the future, SALA will ensure that proposals for funding include applicable overhead costs, where allowed by the grantor.

SALA, however, wishes to comment on the analysis contained in the Draft Report on Page 4, last paragraph. This analysis compares attorney salaries to LSC revenue, however that is only one way to look at it. The Draft Report indicates that "Looking at these percentages may lead LSC stakeholders to believe that LSC funds are not used efficiently and effectively because of the rather limited amount used to provide for lawyers salaries." It is more appropriate to compare the amounts allocated to LSC, Other Government Contracts, and Other Revenue as a percentage of the total, which is what it takes to provide services. As the Draft Report also states on Page 4, Footnote 3, the numbers used do not reflect paralegal and tribal court advocate salaries, who also provide direct services. The chart below compares the total costs by category. The information used is the same information referred to in the Draft Report on Page 4 and which is contained in SALA's 2012 audited financial statement supplemental information.

2012	LSC	Other Government Contracts	Other Revenue	Total (excluding Property)
Total Revenue	$2,397,848 (61%)	$982,903 (25%)	$582,034 (15%)	$3,962,785
Personnel Expenses	$1,641,587 (55%)	$917,935 (30%)	$453,628 (15%)	$3,013,150

Non-Personnel Expenses	$798,799 (79%)	$64,968 (6%)	$152,415 (15%)	$1,016,182
Total Expenses	$2,440,386 (61%)	$982,903 (24%)	$606,043 (15%)	$4,029,332

The above chart reflects that each category of funding is allocated its share of the total costs based upon the revenue received. In 2012, LSC revenue represented 61% of SALA's total revenue and 61% of total expenses, although LSC's share of non-personnel expenses is higher than the other two categories, but this is largely due to how funding is awarded rather than a deficient allocation method.

PROHIBITED PURCHASES

Recommendation 2. *The Executive Director should include in SALA's Accounting Manual policies and procedures the prohibition to use LSC funds for unallowable expenses including, but not limited to, the purchase of flowers, donations in lieu of flowers, holiday parties, alcohol purchases, late fees or finance charges. These policies should be briefed to all grantee staff, emphasizing that LSC's funds are to be used for business purposes only.*

SALA accepts this recommendation and the attached Policy on unallowable costs will be included in SALA's Accounting Manual.

SALA staff is well aware on the prohibition on using LSC funds for alcohol purchases, donations and late fees, and these types of costs have never been paid for using LSC funds. However, in a legal aid agency where attorneys receive the majority of the internal recognition, the purchase of flowers to recognize support employees on Administrative Professional Day is a legitimate and necessary program cost and should be allocable to LSC.

The $1,058.67 amount cited in the Draft Report as a questioned cost is an error. SALA reallocated two of the disbursements totaling $499.19 from LSC to non-LSC funds, and they were not included as an LSC cost in the financial statements as of December 31, 2012. Attached please find the original vouchers for $433.73 and $65.46 which indicate a reversal by general journal entry to non-LSC funds and a copy of the general journal entry showing the reallocation.

ATTORNEYS FEES

Recomendations. The Executive Director should

> Recommendation 3. *formalize in writing policies and procedures for recording and allocating derivative income, including attorneys' fees.*

> Recommendation 4. *ensure that SALA personnel fully implement the requirements of LSC Regulation 45 CFR § 1609.4(A) related to the recording of income derived from attorneys' fees.*

SALA accepts the recommendations. SALA does have a written policy on the Allocation of Derivative Income which was developed in 2010. The Policy, however, was not made part of the Accounting Manual but it was made available to staff. A copy is attached. SALA will make certain that the Policy is made a part of the Accounting Manual.

SALA agrees with the finding relating to the two instances of attorneys' fees which were allocated to other funds instead of LSC. This was an oversight. Other cases where attorneys' fees were awarded and reviewed by the OIG audit team were correctly allocated.

DOCUMENTING POLICIES AND PROCEDURES

Recommendations. The Executive Director should:

> Recommendation 5. *address the following areas in SALA's new contracting policy:*
> - *The number of bids required for "competitive bids"*
> - *The threshold limit for competitive bids*
> - *A reasonable level for the Executive Directors' contract execution limit amount*

SALA accepts Recommendation 5. Attached is a revised Contracting Policy which will be presented to SALA's Board of Directors at its next meeting. However, I want to point out that the Contracting Policy SALA provided was initially reviewed by LSC management and approved prior to approval by SALA's Board of Directors.

Recommendation 6. *develop and incorporate detailed written policies and procedures to document the cost allocation process.*

SALA agrees with the finding and accepts recommendation 6. Attached is a Cost Allocation Policy that will be presented to SALA's Board of Directors after comment by the OIG. Once approved by SALA's Board of Directors, the Policy will be added to SALA's Accounting Manual.

We hope that this Response creates a complete record, and addresses the recommendations of the Office of Inspector General in its Draft Report on Selected Internal Controls at Southern Arizona Legal Aid, Inc. Should you have additional questions or concerns please do advise.

Sincerely,

SOUTHERN ARIZONA LEGAL AID, INC.

Anthony L. Young, Esq.
Executive Director

xc: Audit Finance Committee, Board of Directors
Rose Marie Castro, Chief Financial Officer