LSC

Legal Services Corporation
Office of Inspector General

Inspector General
Jeffrey E. Schanz

December 11, 2008

Andrew Scherer
Executive Director
Legal Services NYC
360 Broadway, 6th Floor
New York, NY 10013

Dear Mr. Scherer:

Attached is the final report on the results of the audit on Selected Internal Controls at Legal Services NYC. The Office of Inspector General (OIG) reviewed your response with regard to the findings and recommendations in the draft report and believe the actions taken or planned will address both recommendations in the report. The OIG considers Recommendation 1 closed. However, since management's actions have not yet been completed to implement Recommendation 2, this recommendation remains open. Because you have already provided this office with your planned actions, you do not need to submit a separate corrective action plan. Please notify this office in writing when you have included the written methodology for allocating indirect costs in your accounting manual so that the final recommendation can be closed.

Thank you and your staff for the cooperation and assistance provided.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Helaine Barnett, President

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LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

LEGAL SERVICES NYC

RNO 233100

Report No. AU09-01

December 2008
www.oig.lsc.gov

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INTRODUCTION

In November, 2007, management of the Legal Services Corporation (LSC) referred for follow-up to the Office of Inspector General (OIG) instances of internal control weakness at certain LSC grantees identified in the Government Accountability Office (GAO) Draft Report entitled, *Legal Services Corporation – Improved Internal Controls Needed in Grants Management and Oversight* or identified in a November 13, 2007 meeting between GAO and LSC staff. The final GAO report (GAO–08–37) was published on December 28, 2007.

LSC management requested that the OIG assess whether the issues specifically identified by GAO had been corrected at each of the grantees referred to the OIG by management.

BACKGROUND

GAO assessed whether LSC's internal controls over grants management and oversight processes provide reasonable assurance that grant funds are used for their intended purposes. GAO analyzed records and interviewed LSC officials to obtain an understanding of LSC's internal control framework, including the monitoring and oversight of grantees, and performed limited reviews of internal controls and compliance at 14 grantees. GAO found control weaknesses at 9 of the 14 grantee sites it visited. These weaknesses included using LSC grant funds for expenditures with insufficient supporting documentation and for unusual contractor arrangements, alcohol purchases, employee interest-free loans, lobbying fees, late fees, and earnest money.

OBJECTIVE

Our overall objective was to determine whether the conditions cited in the GAO report were corrected and controls were put in place by Legal Services NYC (grantee) to detect similar situations and prevent them from recurring. In addition, while on site, we evaluated other selected financial and administrative areas relating to the GAO findings and tested the related controls to ensure that expenditures were adequately supported and allowed under the LSC Act and regulations.

SCOPE AND METHODOLOGY

To accomplish our objective we reviewed controls over the client intake process; employee benefits and reimbursements; disbursements; and internal management reporting/budgeting. To obtain an understanding of the internal controls over these areas, we reviewed grantee policies and procedures, including any manuals, guidelines, memoranda, and directives setting forth current grantee practices. We interviewed grantee officials to obtain an understanding of the internal control framework and interviewed grantee management and staff as to their knowledge and understanding of the processes in place.

We conducted fieldwork at the grantee's central administrative office located in Manhattan, New York City. To test for the appropriateness of expenditures and the existence of adequate supporting documentation, we reviewed disbursements from a judgmentally selected sample of employee and vendor files. To assess the appropriateness of grantee expenditures, we reviewed invoices, vendor lists, and general ledger details. The appropriateness of grantee expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance. This review was limited in scope and was not sufficient for expressing an opinion on the entire system of grantee internal controls or compliance.

The on-site fieldwork was conducted from May 5, 2008 through May 9, 2008. Documents reviewed pertained to the period January 1, 2007 through April 30, 2008. Our work was conducted at the grantee's site and at LSC headquarters in Washington, DC.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

OVERALL EVALUATION

Legal Services NYC (grantee) management had taken appropriate steps to address the issues raised by GAO by implementing controls over the future use of grant funds for alcohol purchases and lobbying fees. However, the grantee still needs to take further steps to preclude the incurrence of late fees.

Grantee disbursements tested were adequately supported, allowable, and properly allocated to LSC except for unallowable late fees and related finance charges of $2,046.04. The disbursements tested disclosed no direct payments from LSC funds for alcohol purchases or lobbying fees. Internal controls over the client intake process in Manhattan, employee benefits and reimbursements, disbursements and internal management reporting/budgeting were operating in a manner expected to ensure compliance with the LSC Act and LSC regulations.

In addition, we did identify one area where internal controls could be strengthened. The grantee's cost allocation process needs to be in writing, included in its Accounting Manual and its application documented.

RESULTS OF AUDIT

FOLLOW-UP ON GAO CONCERNS

GAO identified internal control weaknesses at this grantee dealing with the use of grant funds for alcohol purchases, late fees and lobbying fees.

- Alcohol Purchases and Late Fees

GAO reported that among the control weaknesses found were grantees using LSC grant funds for alcohol purchases and late fees. Our testing of disbursements made by the grantee did not identify any purchases of alcohol using LSC funds. The grantee's purchasing and employee expense reimbursement policies prohibit alcohol purchases. However, our testing did reveal payments of late fees and related finance charges in the amount of $2,046.04. As discussed below under Disbursements and Supporting Documentation, we concluded that the grantee still needs to take steps to preclude the incurrence of late fees.

- Lobbying Fees

GAO identified this grantee as using LSC funds to pay for lobbyist registration fees. Aside from the payments previously identified by GAO, our testing of disbursements did not disclose any specific payments using LSC funds made by the grantee for lobbying fees.

In addition, as a result of GAO concerns, we inquired into the grantee's adherence to the specific recordkeeping requirement for legislative activities set forth in 45 C.F.R. Part 1612. As required, the grantee submitted semi-annual reports to LSC describing their legislative activities with non-LSC funds conducted pursuant to 45 C.F.R. §1612.6. The grantee did not engage extensively in these legislative activities during the period reviewed.

Section 1612.10(b) of LSC's regulations provides that grantees "shall maintain separate records documenting the expenditure of non-LSC funds for legislative and rulemaking activities permitted by [45 C.F.R.] §1612.6." The grantee requires its staff members participating in 45 C.F.R. §1612.6 activities to maintain separate records of their time spent on these activities. The project directors of the constituent corporation branch offices ensure that these staff member salaries are paid at least in part with non-LSC funds. However, the recordkeeping relied on allocations rather than on direct charges of staff member's time. Although this system may result in some level of documentation, it does not ensure that the time spent by staff members on the specific non-LSC funded activity is not charged to LSC funds.

Subsequent to our on-site fieldwork, the grantee's Chief Financial Officer (CFO) provided documentation showing that the grantee modified its timekeeping system in order to track 45 C.F.R. §1612.6 activities specifically within the timekeeping system. Since we believe this policy adequately addresses our concern, no recommendation is necessary and we consider the issue closed.

DISBURSEMENTS AND SUPPORTING DOCUMENTATION

We reviewed a sample of grantee disbursements covering the period January 1, 2007 through March 31, 2008. Our sample was judgmentally selected and included 148 transactions totaling $191,267. We concluded that, except for the following, the disbursements were adequately supported, allowable, and properly allocated to LSC.

- Late Fees

Late fees are not recognized as ordinary and necessary expenditures for the performance of LSC grants. A good financial management system should prevent the incurrence of unnecessary and unreasonable expenses such as penalties or late fees. Under LSC regulation 45 C.F.R. §1630.3 costs may be questioned if they are not reasonable and necessary for the performance of the grant. "A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the same or similar circumstances...." 45 C.F.R. §1630.3(b).

Our sample of disbursements found payments for late fees and related finance charges of $1,879.96 in calendar year 2007 and $166.08 through April of calendar year 2008. These late fees and related finance charges totaled $2,046.04.

The grantee explained that the late fees were incurred because much of the invoice documentation comes to the Finance Office from the grantee's constituent corporations. Delays in receipt and processing at those offices can delay processing and payment by the Finance Office which may result in late fees. The grantee stated that it has been working at reducing late fees by speeding up processing at the constituent corporations.

We consider the late fees and related finance charges of $2,046.04 to be questioned costs and will refer these to LSC management for its review in accordance with LSC regulation 45 C.F.R. §1630.7.

Recommendation 1 – The Executive Director should take further action to improve the processing of invoices so as to not incur future late fees.

Grantee Management Comment The Chief Financial Officer stated: "Legal Services NYC has taken measures since the 1st quarter of 2008 to eliminate late fees. Those measures include:

- Reviewed and isolated vendors who charged late fees to the organization during the last two years. Once identified, routine invoices (primarily equipment leases) were rerouted directly to central, for approval and payment.

- Identified which constituent offices repeatedly submitted invoices late, and communicated findings to the offices' Directors of Administration along with an offer of additional assistance.

- Alerted Accounts Payable to be more cognizant and more proactive in soliciting Requests for Payment from the field for routine expenses that have been historically time sensitive. i.e. credit card payments.

We believe the above measures should eliminate the incurrence of late fees."

INTERNAL CONTROL REVIEW OF SELECTED AREAS

Our review of the internal controls over the client intake process (Manhattan), employee benefits and reimbursements, disbursements, and internal management reporting/budgeting revealed that the controls are operating in a manner expected to ensure compliance with the LSC Act and LSC regulations. We did note one area where internal controls could be strengthened.

- Cost Allocation Process

The grantee's Accounting Manual does not describe the specific procedures to be followed by the grantee in complying with the cost allocation section of the *Fundamental Criteria of an Accounting and Financial Reporting System* (*Fundamental Criteria*) contained in the Accounting Manual for LSC Recipients. The grantee incurred costs for the central office and the legal support unit. These costs were allocated to grantee funding sources, including LSC, through the use of pre-determined rates. However, the grantee did not have documentation readily available to demonstrate how the rates were developed or explain the rationale for the rates.

According to the grantee, the methodology for allocating indirect costs is based on rates that were arrived at several years ago and have not been substantively revised. The grantee explained that the indirect cost allocation methodology used by the grantee replicates an acceptable methodology that complies with 45 C.F.R §1630.3(f), the allocation of indirect costs (allocating indirect costs as a percentage of revenue).

However, without a written methodology for allocating indirect costs included in the Accounting Manual together with supporting documentation detailing application of the methodology, the grantee cannot be assured that its indirect costs are being allocated to LSC in a fair, consistent, and equitable manner.

Recommendation 2 – The Executive Director should include a written methodology for allocating indirect costs in the grantee's Accounting Manual that complies with 45 C.F.R Part 1630 and the Accounting Manual for LSC Recipients. The grantee should apply and document this methodology in allocating its indirect costs.

Grantee Management Comment The Chief Financial Officer stated:
"By the end of the second quarter of 2009 Legal Services NYC will include a written methodology for allocating indirect costs in its accounting manual that complies as needed. The development of the written methodology will resolve the following:

- Identification and documentation of the organizations total indirect costs.
- Identification and documentation of our distribution bases including, e.g., salaries and/or current poor person census data, etc.
- Method(s) for formulating budgets for all funding sources that will fairly, consistently and equitably allocate indirect costs among funding sources with disparate requirements and parameters with respect to direct and indirect cost allocation."

OFFICE OF INSPECTOR GENERAL EVALUATION OF GRANTEE MANAGEMENT COMMENTS

Management actions taken and planned are responsive to the findings and recommendations contained in this report. Since management actions to implement Recommendation 1 have been completed, this recommendation is closed.

While management's comments and planned actions are responsive to Recommendation 2, those actions are not yet complete. Therefore, this recommendation remains open. Because you have already provided your planned actions, you do not need to submit a separate corrective action plan. Please notify this office in writing when you have included the written methodology for allocating indirect costs in your accounting manual so the recommendation can be closed.

APPENDIX I

Legal Services NYC

November 6, 2008

Mr. Anthony M. Ramirez
Office of the Inspector General
Legal Services Corporation
3333 K Street, NW, 3rd Floor
Washington, D.C. 20007-3522

Dear Mr. Ramirez:

Per the October 2 letter from Mr. Ronald Merryman to Andrew Scherer, enclosed please find Legal Service NYC Grantee Management Comments regarding the recommendations indicated in the Report on Selected Internal Controls.

Thank you for bringing the identified matters to our attention. If there are any issues regarding the attached, please let me know.

Regards,

John A. Butler
John Anthony Butler
Chief Financial Officer

Enclosure

C: Andrew Scherer

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Andrew Scherer, Executive Director & President
Fern Schair, Board Chair

LSC

Recommendation 1 – The Executive Director should take further action to improve the processing of invoices so as to not incur future late fees.

Grantee Management Comment

Legal Services NYC has taken measures since the 1st quarter of 2008 to eliminate late fees. Those measures include:

- Reviewed and isolated vendors who charged late fees to the organization during the last two years. Once identified, routine invoices (primarily equipment leases) were rerouted directly to central, for approval and payment.

- Identified which constituent offices repeatedly submitted invoices late, and communicated findings to the offices' Directors of Administration along with an offer of additional assistance.

- Alerted Accounts Payable to be more cognizant and more proactive in soliciting Requests for Payment from the field for routine expenses that have been historically time sensitive. i.e. credit card payments

We believe the above measures should eliminate the incurrence of late fees.

Recommendation 2 – The Executive Director should include a written methodology for allocating indirect costs in the grantees Accounting Manual that complies with 45 C.F.R. Part 1630 and the Accounting Manual for LSC Recipients. The grantee should apply and document this methodology in allocating its indirect costs.

Grantee Management Comment

By the end of the second quarter of 2009 Legal Services NYC will include a written methodology for allocating indirect costs in its accounting manual that complies as needed. The development of the written methodology will resolve the following:

- Identification and documentation of the organizations total indirect costs.
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