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March 31, 2010

Mr. Ramón P. Arias
Executive Director
Bay Area Legal Aid
1735 Telegraph Avenue
Oakland, CA 94612

Dear Mr. Arias:

Enclosed is the Office of Inspector General's (OIG) final report on the results of our audit on Selected Internal Controls at Bay Area Legal Aid. The OIG reviewed your response with regard to the findings and recommendations in the draft report and have determined that the actions taken will address Recommendations 1, 2, 4, and 5 and are thereby closed. Your response to Recommendation 3 is not sufficient to fully address the finding because the new contracting policy does not address some important aspects of the contracting process. This recommendation is being referred to LSC management for further review and will remain open until LSC management has issued a decision and appropriate action has been taken.

We thank you and your staff for your courtesy and cooperation during this audit.

Sincerely,



Jeffrey E. Schanz
Inspector General

cc: Legal Services Corporation
Karen Sarjeant, Vice President
Programs and Compliance

**LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL**

**REPORT ON SELECTED INTERNAL
CONTROLS**

BAY AREA LEGAL AID, INC.

RNO 805270

Report No. AU-10-03

March 2010

www.oig.lsc.gov

EXECUTIVE SUMMARY

Audit Process: The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Bay Area Legal Aid, Inc. (grantee or BayLegal) related to grantee operations and oversight. Audit work was conducted at the grantee's main office in Oakland, CA and at LSC headquarters in Washington, DC. The on-site fieldwork was conducted from June 22 through June 26, 2009.

Results in Brief: Overall, internal controls were generally adequate; however, some controls needed to be strengthened or formalized. Grantee disbursements tested were adequately supported, allowable, and appeared to be properly allocated to LSC. Internal controls over reimbursements and employee benefits were generally adequate and adhered to. However, the grantee had not conducted a physical property inventory count for the past 4 years even though its Accounting Manual and LSC's Accounting Guide for LSC Recipients (August 1997) (Accounting Guide) requires inventories to be taken every 2 years. The grantee's current Accounting Manual does not contain written policies and procedures governing contracting and consultant agreements. The grantee does not currently have a disaster recovery plan in place for information systems.

Internal controls over compliance with specific LSC regulations were adequate with one exception. The grantee has not adhered to the requirement that the board of directors receive a written report concerning compliance with LSC regulation 45 CFR Section 1610.8(b) on which to base its certification of compliance.

Recommendations: The OIG recommends that:

- a physical property inventory be taken at least once every 2 years;
- the results of the physical inventory be reconciled with the accounting records;
- the grantee's Accounting Manual be revised to incorporate formal written policies and procedures governing contracting and consultant agreements;
- a written report to the Board of Directors supporting the grantee's annual Certification of Program Integrity to LSC for 2009 and subsequent years be completed; and
- a disaster recovery plan for information systems be completed and formally implemented.

Summary of Grantee Comments: Grantee management stated that all OIG recommendations had been acted upon. The grantee stated that an inventory was conducted and properly reconciled and that the inventory process and methodology had been documented. The grantee developed a formal written

policy governing contracting and consulting agreements. The grantee stated that an Information Technology Systems Recovery and Business Continuity Plan was adopted and implemented. Management's comments indicated that the Executive Director submitted a written report on Program Integrity to the grantee's Board of Directors in January 2009 and provided the Certification of Program Integrity to LSC.

OIG Evaluation of Grantee Comments: The grantee's comments for recommendations 1, 2, 4 and 5 are responsive to the recommendations contained in the report and are considered closed. Actions on Recommendation 3 regarding the development of a formal written policy governing contracting and consulting agreements are partially responsive to the finding and recommendations. The policy developed by BayLegal contained deficiencies that did not address the documentation requirements for the contracting process, the circumstances and type of documentation required for sole source or noncompetitive bid contracts, and the dollar amount thresholds that would be applicable to a competitive bid process. The OIG considers this recommendation open and will refer it to LSC management for resolution.

TABLE OF CONTENTS

INTRODUCTION	1
OBJECTIVE	1
SCOPE AND METHODOLOGY	1
OVERALL EVALUATION	3
AUDIT FINDINGS.....	3
Property Management.....	3
Recommendation 1	4
Grantee Management Comment.....	4
OIG Evaluation of Grantee Management Comment.....	4
Recommendation 2	4
Grantee Management Comment.....	5
OIG Evaluation of Grantee Management Comment.....	5
Contracting and Consultant Agreements.....	5
Recommendation 3	5
Grantee Management Comment.....	5
OIG Evaluation of Grantee Management Comment.....	6
Information Technology Systems Disaster Recovery Plan	6
Recommendation 4	6
Grantee Management Comment.....	6
OIG Evaluation of Grantee Management Comment.....	7
Documentation for 45 CFR Section 1610.8(b) Certification.....	7
Recommendation 5	7
Grantee Management Comment.....	7
OIG Evaluation of Grantee Management Comment.....	7

APPENDIX I – GRANTEE MANAGEMENT COMMENTS

INTRODUCTION

In accordance with the Legal Services Corporation Accounting Guide for LSC Recipients (August 1997) (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 the process put in place by the grantee designed to provide reasonable assurance of achieving the following objectives:

- safeguarding of assets against unauthorized use or disposition;
- reliability of financial information and reporting; and
- compliance with regulations and laws that have a direct and material effect on the program.

The Accounting Guide further provides that each grantee must rely upon its system of internal accounting controls and procedures to adequately address concerns arising from such issues as defalcations and to meet the complete financial information needs of its management.

OBJECTIVE

The overall audit objective was to assess the adequacy of selected internal controls in place at Bay Area Legal Aid Inc. (grantee or BayLegal) as the controls related to operations and oversight, including program expenditures, fiscal accountability, and compliance with selected LSC regulations. 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. In addition, the OIG examined regulatory policies and grantee processes to assess whether controls were designed in a manner expected to ensure compliance with the LSC Act and the reviewed LSC regulations. However, reaching conclusions regarding compliance with any specific regulation was not an objective of the audit.

SCOPE AND METHODOLOGY

To accomplish the objective, controls over disbursements, internal management reporting and budgeting, selected LSC regulations, and employee benefits and reimbursements were reviewed. To obtain an understanding of the internal controls over these areas, policies and procedures were reviewed, including manuals, guidelines, memoranda, and directives setting forth current practices. BayLegal officials were interviewed to obtain an understanding of the internal control framework and to their knowledge and understanding of the processes in place. Computer-generated data provided by the grantee was relied on to determine whether entries recorded in computer systems matched the

information contained on the source documents. However, the OIG did not test the general or application controls over the computer system.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample represented 21 percent of the over \$12.85 million disbursed during the period January 1, 2008 through May 31, 2009 and consisted of 246 transactions totaling \$2.79 million. To assess the appropriateness of these 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.

To review internal controls over internal management reporting and budgeting, the grantee's system and processes were compared to those detailed in the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the Accounting Guide for LSC Recipients. Controls over employee benefits and reimbursements were reviewed by examining the Collective Bargaining Agreement and other personnel policies and practices, and by testing a judgmentally selected sample of employee reimbursements as part of the disbursements testing.

To review internal controls over compliance with specific LSC regulations (45 CFR Parts 1604, 1610, 1612, 1617 and 1642), written compliance policies and procedures were examined, including those based on applicable LSC mandated recordkeeping requirements, applicable documentation and reports were reviewed, and staff members were interviewed. This allowed the OIG to determine if the controls were designed in a manner to ensure compliance with the provisions of the respective LSC regulation.

This review was limited in scope and not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations or compliance with LSC regulations.

On-site fieldwork was conducted from June 22 through June 26, 2009. Documents reviewed pertained to the period January 1, 2008 through May 31, 2009. Our work was conducted at BayLegal's central administrative office located in Oakland, California and at LSC headquarters in Washington, DC.

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.

OVERALL EVALUATION

Internal controls reviewed at Bay Area Legal Aid, Inc. were adequate as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability, and compliance with LSC regulations. However, some controls need to be strengthened or formalized. Controls over regulations were designed in a manner expected to ensure compliance with the LSC Act and selected LSC regulations, with one exception.

Grantee disbursements tested were adequately supported, allowable, and appear to be properly allocated to LSC funds. The grantee's current practices involving internal management reporting and budgeting were generally in accordance with the *Fundamental Criteria* contained in the Accounting Guide for LSC Recipients. Internal controls over employee benefits and reimbursements were adequate. Policies over employee benefits practices were in writing and adhered to.

The following areas were noted where internal controls could be strengthened:

- The grantee has not conducted a physical property inventory count for the past 4 years even though its Accounting Manual and LSC's Accounting Guide require inventories be taken every 2 years.
- The grantee's current Accounting Manual does not contain written policies and procedures governing contracting and consultant agreements.
- The grantee does not currently have a disaster recovery plan in place for information systems.

Internal controls over compliance with LSC regulations (45 CFR Parts 1604, 1610, 1612, 1617 and 1642), were adequately designed. Written compliance policies and procedures, including those based on applicable recordkeeping requirements, were in accordance with the respective LSC regulation. However, the grantee has not followed the documentation requirement relating to the board of directors' certification required by LSC regulation 45 CFR Section 1610.8(b).

AUDIT FINDINGS

Property Management

The grantee has not conducted a physical property inventory count for the past 4 years.

The LSC Accounting Guide provides that for property control purposes, a physical inventory should be taken and the results reconciled with the property records at least once every 2 years. The Guide also requires that any

differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated and the accounting records should be reconciled to the results of the physical inventory. In addition, the grantee's Accounting Manual provides that property inventories will be taken at least every 2 years and more often when, for example, an office is moved. It further states that the results of the inventory will be reconciled to the property records and the accounting records. During the course of fieldwork, management verbally provided a general timeframe for the last property inventory but could not provide documentation to show the actual date of that inventory.

Subsequent to the audit fieldwork, the grantee provided an asset listing of its property inventory, reconciled to the accounting records as of December 31, 2008. While the asset listing was useful, no additional information was provided as to when or how the inventory process that resulted in this asset listing was undertaken by the grantee.

Not only are physical inventories required by LSC, they help protect the grantee's assets and help ensure that thefts or losses of property are quickly detected. Adequate property records enable the grantee to fully account for fixed asset purchases and to support property asset balances in its financial statements.

Recommendations - The Executive Director should:

Recommendation 1. Ensure that a physical property inventory is taken at least once every 2 years and the results reconciled with the accounting records.

Grantee Management Comment. The Executive Director stated:

BayLegal will ensure that a physical property inventory is taken at least once every 2 years and the results reconciled with the accounting records. In 2009, BayLegal conducted a physical property inventory and reconciled the results with the fixed asset balance in its financial statements.

OIG Evaluation of Grantee Management Comment.

Grantee management comments are responsive to this recommendation. The OIG considers this recommendation closed.

Recommendation 2. Maintain written documentation detailing the process and methodology utilized to conduct the grantee's property inventory.

Grantee Management Comment. The Executive Director stated:

BayLegal maintains written documentation detailing the process and methodology utilized to conduct its property inventory. In 2009, BayLegal's Director of Operations identified and reconciled the pre-numbered inventory tags on all property and equipment to the Physical Inventory of Property & Equipment sheet and verified its location.

OIG Evaluation of Grantee Management Comment.

Grantee management comments are responsive to the recommendation. However, management should not only maintain written documentation of the process and methodology for conducting inventories, but ensure that the process and methodology is formally included in the appropriate policy manual. The OIG considers this recommendation closed.

Contracting and Consultant Agreements

BayLegal does not have a formal written policy governing the administration of contracts and consultant agreements. The grantee appears to maintain a reasonable and standardized practice in selecting contractors and consultants. However, there are no written policies and procedures in the grantee's Accounting Manual. Without such policies and procedures describing the process, there is no assurance that staff will follow a consistent approach to contracting actions. Formal written policies and procedures are vital to a strong control structure by ensuring that the established controls are communicated to all staff and that appropriate approvals and authorizations are obtained to protect resources.

Recommendation 3. The Executive Director should develop formal written policies and procedures governing contracting and consultant agreements.

Grantee Management Comment. The Executive Director stated:

The OIG audit team reviewed several of BayLegal's contracting and consultant agreements during its on-site field work. The OIG audit team also interviewed the Executive Director and other members of BayLegal's management team regarding the process used to enter into specific contracting and consultant agreements, including the bidding process used to

select the general contractor for the renovation of the Oakland office and the selection of the consultant who worked on the Technology Initiative Grant awarded in 2003. The Draft Report finds that BayLegal appears to maintain a reasonable and standardized practice in selecting contractors and consultants.

BayLegal has developed a formal written policy governing contracting and consulting agreements (enclosed).

OIG Evaluation of Grantee Management Comment.

Grantee management comments are partially responsive to the finding and recommendation. While a policy on contracting and consulting agreements was developed, the policy contained deficiencies. The new policy does not address documentation requirements for the contracting process. Nor does the policy address the circumstances and the type of documentation required for sole source or noncompetitive bid contracts. In addition, the policy does not detail the circumstances or dollar amount thresholds that would be applicable to a competitive bid process. This finding will be referred to LSC management for resolution. As such, the OIG considers this recommendation open.

Information Technology (IT) Systems Disaster Recovery Plan

Although currently developing one, the grantee does not have a written disaster recovery plan in place for its IT systems. According to grantee management, the plan is not yet complete because the grantee's focus is on daily operations.

IT systems play a vital role in accomplishing the grantee's mission. Because these systems are subject to a variety of disruptions, management must assess risks facing the organization, including the possibility of temporary or prolonged outage of its information systems. Without a disaster recovery plan in place and tested, the grantee has no assurance that it will be able to adequately provide services to its client base should information systems fail.

Recommendation 4. The Executive Director should ensure a disaster recovery plan for information systems is completed.

Grantee Management Comment. The Executive Director stated:

BayLegal has adopted and implemented an Information Technology Systems Disaster Recovery and Business Continuity Plan (enclosed).

OIG Evaluation of Grantee Management Comment.

Grantee management comments are responsive to the recommendation. The OIG considers this recommendation closed.

Documentation for 45 CFR Section 1610.8(b) Certification

45 CFR Section 1610.8(b) of LSC's regulations requires the Board of Directors to annually certify to LSC the grantee's compliance with LSC's program integrity requirements. An LSC program letter requires the grantee's executive director to submit a written report to the Board on the grantee's compliance with those requirements.¹ The Executive Director had not prepared a written report to provide to the governing body for its preparation of the Certification of Program Integrity.

The Executive Director stated that no written reports had been submitted to the governing body. He stated that the reports were always given orally. He further stated that the grantee would adhere to the requirement in the future.

A written report is required by LSC and helps ensure that all required information is given to the Board so that it may undertake the required review of compliance with the regulation. The written report also provides support for and an accurate record of the information on which the Board is basing its certification.

Recommendation 5. The Executive Director should complete and submit a written report to the Board of Directors supporting the grantee's annual Certification of Program Integrity to LSC for 2009 and subsequent years.

Grantee Management Comment. The Executive Director stated:

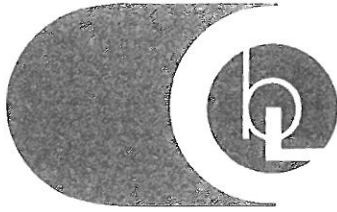
The Executive Director submitted a written report on BayLegal's program integrity to the Board of Directors in January 2010 and provided the Certification of Program Integrity to LSC.

OIG Evaluation of Grantee Management Comment.

Grantee management comments are responsive to the recommendation. The OIG considers this recommendation closed.

¹ Memorandum from John A. Tull, Director, Office of Program Operations, to all LSC Program Directors and Board Chairs regarding "Certification of Program Integrity" (Oct. 30, 1997).

Ramón P. Arias
Executive Director



BAY AREA LEGAL AID

WORKING TOGETHER FOR JUSTICE

February 12, 2010

Ronald D. Merryman
Assistant Inspector General for Audit
Office of the Inspector General
Legal Services Corporation
3333 K Street, NW, 3rd Floor
Washington, D.C. 20007-3558

Re: BAY AREA LEGAL AID - RNO 805270
Comments to Draft Report Issued January 2010

Dear Mr. Merryman:

Below are Bay Area Legal Aid's (BayLegal) comments to your office's recommendations on selected internal controls.

Recommendation 1: The Executive Director should ensure that a physical property inventory is taken at least once every 2 years and the results reconciled with the accounting records.

Comment: BayLegal will ensure that a physical property inventory is taken at least once every 2 years and the results reconciled with the accounting records. In 2009, BayLegal conducted a physical property inventory and reconciled the results with the fixed asset balance in its financial statements.

Recommendation 2: The Executive Director should maintain written documentation detailing the process and methodology utilized to conduct the grantee's property inventory.

Comment: BayLegal maintains written documentation detailing the process and methodology utilized to conduct its property inventory. In 2009, BayLegal's Director of Operations identified and reconciled the pre-numbered

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inventory tags on all property and equipment to the Physical Inventory of Property & Equipment sheet and verified its location.

Recommendation 3: The Executive Director should develop formal written policies and procedures governing contracting and consultant agreements.

Comment: The OIG audit team reviewed several of BayLegal's contracting and consultant agreements during its on-site field work. The OIG audit team also interviewed the Executive Director and other members of BayLegal's management team regarding the process used to enter into specific contracting and consultant agreements, including the bidding process used to select the general contractor for the renovation of the Oakland office and the selection of the consultant who worked on the Technology Initiative Grant awarded in 2003. The Draft Report finds that BayLegal appears to maintain a reasonable and standardized practice in selecting contractors and consultants.

BayLegal has developed a formal written policy governing contracting and consulting agreements (enclosed).

Recommendation 4: The Executive Director should ensure that a disaster recovery plan for information systems is completed.

Comment: BayLegal has adopted and implemented an Information Technology Systems Disaster Recovery and Business Continuity Plan (enclosed).

Recommendation 5: The Executive Director should complete and submit a written report to the Board of Directors supporting the grantee's annual Certification of Program Integrity to LSC for 2009 and subsequent years.

Comment: The Executive Director submitted a written report on BayLegal's program integrity to the Board of Directors in January 2010 and provided the Certification of Program Integrity to LSC.

Sincerely,


Ramon Arias
Executive Director

Enclosures