Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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February 2, 2015

Ms. Sara E. Strattan
Executive Director
Community Legal Aid Services
50 South Main Street
Akron, OH 44308

Dear Ms.Strattan:

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

In the issued draft report, Recommendation 4 had been inadvertently omitted, which resulted in there being two recommendations numbered 7. We have correctly renumbered the recommendations in the final report. However, for ease of reference, we are addressing them in the response under the original numbers in the draft report.

The OIG considers the proposed actions to address Recommendations 2, 6, the first Recommendation 7 and 8 as responsive. However, all four recommendations will remain open until the OIG is notified in writing that the proposed action has been completed and supporting documentation provided.

Grantee management accepted the second Recommendation 7, and stated that they have documented policies and procedures for contracting. This recommendation is considered closed.

The grantee's comments are not responsive to Recommendations 1, 3 and 5. The responses do not include the planned action and procedures that will be performed at this time to correct the specific issues. We will refer these recommendations to LSC management for resolution.

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

COMMUNITY LEGAL AID SERVICES, INC.

RNO 436030

Report No. AU 15-03

February 2015

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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 Community Legal Aid Services, Inc. (CLAS or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Akron, Ohio 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

According to the audited financial statements for the fiscal year ended December 31, 2013, CLAS received $1,946,263 from LSC and $3,479,770 from other non-LSC funders. The grantee's main office is located in Akron, Ohio and according to the CLAS website; the grantee provides civil legal services to residents of Columbiana, Mahoning, Medina, Stark, Summit, Portage, Trumbull and Wayne Counties. According to LCS's 2012 grantee profile, the grantee has approximately 60 staff: 26 attorneys, 11 paralegals and 23 support staff.

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, 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 the areas listed below that need to be improved.

FIXED ASSETS

The grantee did not have evidence that it conducted physical inventories of its capitalized fixed assets. CLAS' written policies and procedures relating to capitalized fixed assets were in accordance with the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide, except all the recordkeeping elements required for the property records were not listed in the grantee's Accounting Manual. In addition, the individual property records completed for each fixed asset did not detail all the elements required by the *Fundamental Criteria*.

a. Capitalized Assets

The OIG could not confirm that the grantee conducted physical inventories of its fixed assets. While the grantee's written policy detailed that a physical inventory will be taken at least every two years, the OIG could not confirm that this was done. The grantee stated that a physical inventory was performed in 2012, but could not provide records. The Accounting Manager stated that the physical inventory records could not be located as they were originally maintained by an accountant who is no longer with the grantee. The LSC Accounting Guide Chapter 2-2.4 and the grantee's written policies detail that a physical inventory should be taken and the results reconciled with the property records at least once every two (2) years. Any differences between quantities determined by the physical inspection and those shown in the accounting records will be investigated to determine the causes of the difference with the accounting records and then reconciled to the results of the physical inventory.

Properly accounting for fixed assets enables the grantee to safeguard its assets, and fully account for the assets purchased.

CLAS' fixed assets written policies and procedures were generally comparable to the LSC *Fundamental Criteria,* except that the CLAS Accounting Manual did not list all elements required to be detailed in the property records. The missing elements that need to be listed in the written policies include:

- the date of purchase of the asset;
- the check number used for the purchase; and
- the source of funds used to purchase the asset.

In addition, the individual property records did not list all elements required to be detailed in the property record. The missing elements that need to be included in the individual property record are:

- the check number used for the purchase; and
- the source of funds used to purchase the asset.

b. Non-Capitalized Assets

The grantee did not have a complete list of all its operational computers. According to the grantee's policy, property acquisitions of non-capitalized items are not tagged. Only property valued in excess of $5,000 is tagged and capitalized and consequently, items such as computers, unless purchased in bulk, are not tagged because their value is less than $5,000. The LSC Accounting Guide states that grantees should be mindful of items that may contain sensitive information, such as computers, with values lower than $5,000 and must inventory these items appropriately.

Our review of the grantee's controls over non-capitalized items revealed areas needing improvement. CLAS had an IT project in April 2014 where they purchased 9 laptops and 25 monitors and computers. The new IT Director maintains a record of all the IT equipment purchased for this project. An Asset Acquisition form is utilized to track these purchases and lists the locations and descriptions of all the new IT equipment purchased.

In addition, for the laptops and flash drives, the IT Director developed a web based tracking sheet. The OIG traced the laptops to the list and verified that the Google based checkout form had adequate controls for tracking these specific electronic items. The form listed the employee name, device name, device number, and date and time stamp of the rental and return.

However, the OIG noted the Asset Acquisition form only listed the newly purchased computers in 2014 and that the web-based tracking sheet only covered laptops and flash drives purchased in 2014. Neither tracking system listed all the grantee's operational computers and IT equipment.

Without an adequate and complete tracking system for all its electronic items, there is no assurance that the grantee is properly safeguarding the equipment and the information contained therein.

Recommendations: The Executive Director should:

Recommendation 1: improve the physical inventory process to ensure that a physical inventory count is conducted every two years and accounted for as required by the *Fundamental Criteria* and the LSC Accounting Guide;

Recommendation 2: update the CLAS Accounting Manual to list all elements required in the property record in accordance with the LSC *Fundamental Criteria*; and

Recommendation 3: enhance the current tracking system over non-capitalized assets to include all operational computers and IT equipment in service.

DISBURSEMENTS

For the most part, disbursements tested were adequately supported, properly approved, and allowable. Nevertheless, our testing revealed processes that need to be improved. Of the 83 disbursements tested, a portion of 8 disbursements were incorrectly allocated to LSC funding and 10 disbursements were either inappropriately approved or the documentation not adequately marked paid. Ensuring allowable costs, obtaining adequate approval and appropriately marking documents paid helps to ensure that funds are only used for authorized purposes.

Incorrectly allocated costs

LSC funds were used to pay for a portion of eight disbursements (representing 11 transactions). The portion that was allocated to LSC was unallowable as the costs were incurred for purchases of flowers. These costs were initially recorded to a general expense account and then a portion of that cost allocated to LSC in accordance with the grantee's cost allocation methodology.

According to the grantee, it was not aware that such expenses were unallowable under the LSC grant. 45 CFR Part 1630 provides in part that the grantee must demonstrate that the expenditure is reasonable and necessary for the performance of the grant or contract as approved by LSC.

Although the grantee has a written policy stating that only dues required for the practice of law may be paid with LSC funds, the grantee did not have written policies detailing other specific unallowable expenses. However, the grantee said that it was aware that alcohol, late fees and finance charges were unallowable costs and charged such expenses to non-LSC funding.

Ensuring allowable costs for disbursements helps to affirm that LSC funds are only used for authorized purposes.

Inadequately processed disbursements

Check request approvals were not adequate for three disbursements made on behalf of the Executive Director. The check requests were approved by the Executive Director herself and she was aware that her travel and other expenses should be approved by the Board but was not aware that she could not approve her own disbursements for bar dues. The LSC Accounting Guide Chapter 3-5.4 provides that approval should be required at an appropriate level of management before a commitment of resources is made.

Although the grantee's written policy states that Managing Attorneys and Administrative Supervisors are responsible for the review and approval of invoices, it does not provide for the level of approval required for the Executive Director's transactions.

Appropriate approval ensures disbursements are made with the knowledge of an appropriate level of management.

In addition, seven disbursements were not marked paid or otherwise canceled. Although the grantee stated the unstamped invoices were due to an oversight, it did not have any written policies to safeguard against duplicate payments. LSC Accounting Guide Chapter 3-5.4 provides that documents should be marked paid or otherwise canceled to avoid duplicate payment. The check number and pay date should also be noted on the invoice or other supporting documentation.

Annotating the invoice and supporting documentation that the vendor has been paid helps ensure that duplicate payments are not made.

Recommendations: The Executive Director should:

> Recommendation 4**:** revise the disbursement policy to include specific LSC unallowable expenses and ensure that LSC funds are only used to pay LSC allowable costs.
>
> Recommendation 5: revise the disbursement policy to include approval levels required for the Executive Director's transactions and ensure that approvals are obtained from appropriate levels of management.
>
> Recommendation 6: revise the disbursement policy to include duplicate payment controls and ensure that disbursement policies are enforced to avoid duplicate payments.

WRITTEN POLICIES

Operating practices in place for two areas reviewed were not documented in the grantee's Accounting Manual in accordance with the *Fundamental Criteria* contained in the LSC Accounting Guide. The CLAS Accounting Manual documents the policies and procedures to be followed by CLAS staff in meeting the objectives and criteria of LSC and its other funding sources. The grantee's current practices in use involving soliciting and awarding contracts and accounting for derivative income were generally in accordance with the *Fundamental Criteria*, but these practices need to be fully documented.

Grantee management stated that while there are no written contract and consulting policies, it uses a very limited number of contract vendors and that the grantee abides by their capital acquisition policy of attempting to get three or more bids. For the four contracts reviewed, there appeared to be adequate contracting practices. There was documentation on file supporting contract decisions and payments made to the vendor that agreed with the contract terms. Grantee management also stated that it is currently working on a draft written policy.

The grantee received derivative income in the form of attorneys' fees, interest and miscellaneous income. Although the grantee did not have documented policies accounting for derivative income, attorneys' fees were allocated based on the hours spent on the case and funding source in accordance with 45 CFR §1609.4 (a), while the interest income was allocated based on the fund balance at the end of the year. Miscellaneous income was allocated to the general fund since the income was not derived from any specific funding source. The grantee stated they were not aware that policies and procedures relating to derivative income needed to be documented.

In establishing an adequate 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 <u>Accounting Guide</u>.

45 CFR § 1609.6 provides that grantees shall adopt written policies and procedures to guide its staff in complying with the regulation.

Without adequate written policies and procedures in place, transactions may be initiated and recorded that violate management intentions, or possibly laws or grant restrictions. Written policies and procedures also serve as a method to document the design of controls and to communicate the controls to the staff.

<u>Recommendations</u>: The Executive Director should:

> <u>Recommendation 7</u>**:** document policies and procedures for contracting to conform to all the elements of LSC's *Fundamental Criteria*.
>
> <u>Recommendation 8</u>**:** document policies and procedures for accounting for derivative income to include the requirements set forth by the <u>Accounting Guide</u> and by 45 CFR § 1609.6 for attorneys' fees.

SUMMARY OF GRANTEE MANAGEMENT'S COMMENTS

Grantee management agreed with five recommendations contained in the report while other comments were not responsive to the other three recommendations.

Grantee management stated they will amend the accounting manual to include all elements in the property record as required by the LSC *Fundamental Criteria*. They also stated that they will adopt a policy requiring all expenses of the Executive Director be approved by the President of the Board. In addition, the grantee stated that they have documented policies and procedures for contracting and will adopt policies and procedures to account for derivative income.

Grantee management stated that they maintain an inventory of all capitalized assets that have not been fully depreciated, which is updated annually. With regard to non-capitalized items, the grantee stated they maintain a tracking system but need clarification on the items that need to be tagged. Grantee management had a difference of opinion on the allowability of the cost of flowers, relying on the IRS definition of de minimus fringe benefits as opposed to 45 CFR Part 1630.

The grantee stated that although there has been no problem with duplicate payments, they will review the recommendation further with their auditors to consider additional controls. The grantee also stated that there were 878 transactions and, as a result, the OIG found an error rate of .22 percent.

Grantee management's formal comments can be found in Appendix II.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the proposed actions to address Recommendations 2, 6, the first Recommendation 7 and 8 as responsive. The actions planned by grantee management to address the issues and revise and update its Accounting Manual should correct the issues identified in the report. However, all four recommendations will remain open until the OIG is notified in writing that the proposed actions have been completed and supporting documentation provided. It is also noteworthy to clarify the grantee's comments on the first Recommendation 7. The OIG's disbursement sample selection was 67 vendor files, which consisted of 83 disbursements, with 86 transactions tested. The number of exceptions identified, 18/83 at 22 percent, was significant to the sample tested.

Management accepted the second Recommendation 7, and stated that they have documented policies and procedures for contracting. This recommendation is considered closed.

The grantee's comments are not responsive to Recommendations 1, 3 and 5.

For Recommendation 1, the grantee did not provide evidence that a physical inventory had been conducted according to the *Fundamental Criteria*. LSC guidelines are very clear on the inventory requirements. In addition, the OIG does not understand the grantee's reference to office supplies in its response.

Recommendation 3 is to enhance the tracking system over non-capitalized assets, which include all operational computers and IT equipment in service. It is the responsibility of grantee management to establish an adequate tracking system and tag these non-capitalized items.

With respect to Recommendation 5 and the allocation of LSC funds to the cost of flowers, OIG follows LSC's policy. LSC mandates that the grantee must demonstrate the expenditure is reasonable and necessary for the performance of the grant or contract as approved by LSC. LSC does not consider this a necessary expense and therefore cannot be purchased with LSC funds.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Cash disbursements,
- Cost Allocation,
- Contracting,
- Credit cards,
- Property and Equipment,
- Internal Management Reporting and Budgeting,
- Salary Advances, and
- Client trust funds.

We also reviewed controls over derivative income and client trust fund accounting. Controls over derivative income were reviewed to determine whether income was properly recorded and allocated.

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 practices. Grantee officials were interviewed to obtain an understanding of the internal control framework. 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 the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample was taken from the period January 1, 2013 through May 31, 2014, and represented approximately 5 percent of the $3,270,324 disbursed for expenses other than payroll and consisted of 83 disbursements totaling $170,046. To assess the appropriateness of expenditures, we reviewed invoices, 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 the adequacy of the cost allocation process, we discussed the cost allocation process for 2013 with grantee management and reviewed the written cost allocation policies and procedures as required by the LSC Accounting Guide. We recalculated the cost allocation amounts for 2013 using the information provided by the grantee.

To evaluate and test internal controls over the contracting process, credit card use, internal management reporting and budgeting, and property and equipment, we interviewed appropriate program personnel, examined related policies and procedures, and selected specific transactions to review for adequacy.

Controls over salary advances were reviewed by examining the personnel policies and practices. The grantee's policy allows for salary advances to employees. However, we did not identify any salary advances on the check register and the grantee also stated that no salary advances had been provided within the last three years. Therefore, no testing was performed.

To evaluate controls over client trust fund accounting, we interviewed appropriate program personnel and examined related policies and procedures. We reviewed actual client trust account transactions to ensure receipt, disbursement and reconciliation procedures for client trust funds are correctly recorded and accounted for in the general ledger.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the grantee's Accounting Manual.

The on-site fieldwork was conducted from June 16 through June 25, 2014. Our work was conducted at the grantee's central administrative office in Akron, Ohio and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2013 through May 31, 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 that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

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APPENDIX II

December 19, 2014

Mr. John M. Seeba
Assistant Inspector General for Audit
Office of Inspector General
Legal Services Corporation
3333 K Street, NW
Washington, D.C. 20007

Re: Recipient No. 436030
Draft Report Selected Internal Controls June 15 – 25, 2014

Dear Mr. Seeba:

Thank you for the opportunity to comment on the recommendations in the draft report referenced above.

Our comments to the draft report are attached.

Very truly yours,

Sara E. Strattan
Attorney at Law

SES:sb

Enclosure

***Recommendation 1**: Improve the physical inventory process to ensure that a physical inventory count is conducted every two years and accounted for as required by the Fundamental Criteria in the LSC Accounting Guide.*

Response: CLAS maintains an inventory of all capitalized assets which have not been fully depreciated. This inventory is updated annually. After extensive discussions with the audit team members we understand that the OIG prefers that certain office supplies should be included in this inventory. We are in need of clarification on which office supplies should be included. In addition, we would like clarification on whether or not the OIG requires inclusion of fully depreciated assets.

***Recommendation 2**: Update the CLAS Accounting Manual to list all elements required in the property record in accordance with the LSC Fundamental Criteria.*

Response: The CLAS Accounting Manual states the elements of our recordkeeping system. Because NO fixed assets are ever purchased with LSC Funds CLAS does not follow all of the criteria as described in the accounting guide for LSC recipients. We will amend the accounting manual to include the required use of the more stringent LSC record keeping requirements for any assets purchased with LSC funds.

***Recommendation 3**: Enhance the current tracking system over non-capitalized assets to include all operational computers and IT equipment in service.*

Response: All of our newly purchased computer items have been tagged. Our IT equipment which does not stay at a work station (laptops, flash drives, etc.) are all named or numbered and there is a tracking system for them which is maintained by the IT department. When the auditors were here, the IT department reviewed with them the value of the untagged items which were in use. After that conversation our IT people understood that they did not have to be tagged. For purposes of clarification, we would like to confirm that all non-capitalized IT equipment, including laptops, projectors, scanners, mice, flash drives, individual telephones, monitors, etc. must be inventoried annually.

***Recommendation 4**:*

Response: We did not see a recommendation 4 in the draft report.

***Recommendation 5**: Revise the disbursement policy to include specific LSC unallowable expenses and ensure that LSC funds are only used to pay LSC allowable costs.*

Response: We understand that the allocation of the portion of the cost of flowers sent to an employee is not permitted by the OIG.

In making this determination the OIG relies on 45 CFR 1630.2(g)(3) which states that questioned costs include those which appear *unnecessary or unreasonable and does not reflect the actions a prudent person would take in the circumstances* and 45 CFR 1630.3(2) regarding allowable costs which states that recipients must be able to demonstrate that the cost is *reasonable and necessary for the performance of the grant or contract as approved by the Corporation.*

We believe, however, that such expenses come under the IRS definition of de minimus fringe benefits which are defined in Section 132 of the IRS Code as *any property or service the value of which is, after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees, so small as to make accounting for it unreasonable or administratively impracticable.* Specific examples are provided under Section 132.6(4)(3): examples of de minimus fringe benefits are occasional typing of personal letters by a company secretary, ….. local telephone calls; <u>and flowers, fruit, books, or similar property provided to employees under special circumstances (e.g., on account of illness, outstanding performance, or family crisis</u>.

It is common business practice to send flowers / fruit etc. under special circumstances. This gesture goes a long way in keeping up morale which in turn gives employees a more positive attitude toward their work and in the end benefits the clients we serve.

In spite of this difference of opinion, should the OIG continue to require that no portion of the cost for flowers, fruit, books or similar property provided to employees under special circumstances, we will ensure that we do not bill such expenses to LSC.

<u>Recommendation 6</u>: Revise the disbursement policy to include approval levels for the Executive Director's transactions and ensure that approvals are obtained from appropriate levels of management.

<u>Response</u>: The Executive Director's expenses are routinely approved by the President of the Board of Trustees. Several notices for annual bar association dues were not approved by the Board President as the payments were not advanced by the Executive Director. These expenses were not paid for with LSC funds. We will adopt a policy requiring that all expenses of the Executive Director be approved by the President of the Board.

<u>Recommendation 7</u>: Revise the disbursement policy to include duplicate payment controls and ensure that disbursement policies are enforced to avoid duplicate payments.

<u>Response</u>: The auditors reviewed 60 vendor files with payment documentation for 878 transactions. They found an error rate of .22% with seven disbursements not marked paid or otherwise cancelled and two paid invoices were stamped "posted" but not stamped "paid." We understand that the auditors were concerned that there was a possibility that the item could be paid twice.

Although we have never had a problem with duplicate payments, and our computer software will not permit duplicate payments, we will review this recommendation with our auditors to see if there are additional controls that they recommend.

Recommendation 7**: Document policies and procedures for contracting to conform to the elements of LSC's Fundamental Criteria.**

Response: We have done so.

Recommendation 8**: Document policies and procedures for accounting for derivative income to include the requirements set forth by the Accounting Guide and by 45 C.F.R. § 1609.06 for attorney fees,**

Response: We will adopt policies and procedures for accounting for derivative income.