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Legal Services Corporation

Inspector General
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August 7, 2014

Anna Marie Johnson
Executive Director
Nevada Legal Services, Inc.
530 South 6th Street
Las Vegas, NV 89101

Dear Ms. Johnson:

Enclosed is the Office of Inspector General's (OIG) final report of our audit on Selected Internal Controls at Nevada Legal Services, Inc. (NLS). The OIG reviewed your comments on the findings and recommendations contained in the draft report. Your comments are included in the final report as Appendix II.

The OIG does not consider your comments to Recommendations 1, 8, and 9 responsive and is referring them to LSC management for resolution. In addition, in accordance with 45 CFR § 1630.7, the OIG is referring the questioned costs related to Recommendation 1 to LSC management for resolution. The questioned costs consist of $1,246 of unallowable charges and $728 of inadequately supported costs.

The OIG considers your comments to Recommendations 3, 4, 5, 6, 7, 10, 13, and 14 partially responsive. They will remain open until the OIG has been notified in writing that the applicable written policies have been updated and added to the Accounting Manual and all meetings and training to discuss adherence with accounting policies and procedures has been completed with NLS staff. The OIG considers your explanations and actions responsive to Recommendations 2, 11, and 12 and those recommendations are considered closed.

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

REPORT ON SELECTED INTERNAL CONTROLS

NEVADA LEGAL SERVICES, INC.

RNO 829050

Report No. AU 14-08

August 2014

www.oig.lsc.gov

TABLE OF CONTENTS

INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Nevada Legal Services, Inc. (NLS or grantee) related to specific grantee operations and oversight. We conducted audit work at the grantee's administrative office in Las Vegas, Nevada 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.

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

Nevada Legal Services, Inc. needs to strengthen internal controls and enhance written policies and procedures to comply with the Accounting Guide and LSC regulations, and adhere more closely to its established written policies.

We tested 85 disbursements totaling $185,845 for which the grantee charged $106,657 to LSC funds. Of the 85 disbursements, we found 21 that were unallowable, inadequately supported, or improperly approved.

Generally, the cost allocation methodology used by NLS appeared reasonable, except that it did not include a provision for allocating indirect costs prohibited by LSC regulations. The OIG noted that NLS used LSC funds to pay for expenses prohibited by LSC regulations because of the flaw in the design of the cost allocation methodology. In addition, the grantee's written cost allocation policy was outdated.

The grantee's contracting policies were missing critical elements required by the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide, including guidelines for securing various types of contracts, competition requirements, and executing contracts that deviate from standard procedures. The grantee's policy stipulated that the Board of Directors had to approve purchases over $5,000, but management did not adhere to this requirement. Additionally, management stated that it had secured competitive bids for purchases over $500, but the OIG did not find evidence of the bidding process in the grantee's practice or its written policy.

NLS had internal controls in place regarding employee benefits, but did not always adhere to the established controls. The grantee had adequate written policies in place, but management overrode these written policies.

The grantee's written policies and procedures regarding fixed assets were in accordance with the *Fundamental Criteria* contained in the Accounting Guide. However, the grantee did not retain sufficient evidence to substantiate that they had performed an inventory of fixed and physical assets, or that they had reconciled the assets to property records. Without appropriate evidence, the OIG could not confirm that management actually performed the inventory. In addition, property records retained by NLS management, for physical assets were missing key recordkeeping elements required by the Accounting Guide.

The grantee did not have adequate internal controls in place governing the use and issuance of credit cards. NLS did not have a written policy outlining acceptable uses of credit cards. Nevada Legal Services, Inc., Accounting Manual (Accounting Manual) stipulated that management must approve all charges but did not detail the types of purchases that cardholders were authorized to make with the credit cards. The OIG found three unallowable transactions totaling $781, charged to NLS credit cards.

NLS did not have a written policy regarding derivative income. Although the grantee handled the derivative income earned during the audit scope correctly, management should formalize applicable policies and procedures in writing.

The grantee had adequate internal controls in place over the internal reporting and budgeting process. The policies and procedures for internal reporting and budgeting, outlined in the Accounting Manual, were comparable to the *Fundamental Criteria* and NLS adhered to the policies.

AUDIT FINDINGS

DISBURSEMENTS

The OIG tested 85 disbursements totaling $185,845 for which the grantee charged $106,657 to LSC funds.[1] Of the 85 disbursements, we found 21 that were unallowable, inadequately supported, or improperly approved. The total amount charged to LSC from these disbursements was $15,802.

Specifically, the OIG noted:

- fourteen unallowable disbursements;
- five inadequately supported disbursements; and
- two disbursement that were not approved by the grantee's Board of Directors, as stipulated by the grantee's internal policies.

Ensuring that costs are allowable, maintaining adequate supporting documentation for expenditures, and approving disbursements appropriately helps to ensure that grantees use funds only for authorized purposes.

LSC Regulation, 45 CFR Part 1630, Costs Standards and Procedures, provides that grantee expenditures should be reasonable and necessary for the performance of the grant or contract and that grantees should adequately document expenditures. The *Fundamental Criteria* also states that disbursements require adequate documentation, contained in grantee files, to support the reason for each disbursement.

Section III C 1, Cash Disbursements Policies of Nevada Legal Services, Inc. Accounting Manual (Accounting Manual) states that no funds will be disbursed, regardless of the source, for any purpose specifically prohibited by LSC Act or regulations. LSC OIG noted that NLS does not abide by this policy. In addition, the Accounting Manual advises that the Executive Director shall regularly review all disbursements to ensure compliance with all NLS policies and applicable fund(s) restrictions.

Section 2-3.1, Grant and Contract Costs, of the Accounting Guide stipulates that costs of alcohol are not allowable as a charge to federal funds.

The grantee's Accounting Manual stipulates that the Board of Directors is responsible for entering into appropriate contractual agreements on behalf of the Program, including but not limited to funding grants, leases, and purchases of property and/or equipment in excess of $5,000.

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[1] The OIG reviewed eighty-two (82) transactions dated within the audit scope: January 1, 2012 to September 30, 2013. The total amount of these transactions was $170,898. The OIG reviewed three (3) transactions outside of the audit scope, dated October 21, 2013 and November 1, 2013, that totaled $14,947.

Unallowable Costs

NLS used LSC funds to pay for 14 disbursements, totaling approximately $1,246, for unallowable purposes. The OIG noted:

- two disbursements, totaling $765, for purchases of alcohol;
- two disbursements, totaling $222, for flowers;
- four disbursements, totaling $153, for membership dues, paid on behalf of employees, to a warehouse retailer; and
- six disbursements, totaling $106, for late fees on revolving credit accounts, utility bills, and office machine rentals.

NLS management approved all of the invoices for unallowable disbursements following internal accounting procedures. Consequently, the internal control structure, built into the approval process, was not functioning properly.

For 12 of the 14 unallowable disbursements, the expenditures for flowers, membership dues, and late fees, totaling $481, the cost allocation methodology used by NLS was a proximate cause of the breakdown in internal control. When incurred, the grantee assigned these indirect expenses to a generic cost pool. At the end of each month, the Fiscal Administrator re-allocated the costs across applicable funding sources, including LSC, according to the cost allocation formula even though the charges were not allowed by LSC regulations.

Finally, the cause of the two unallowable disbursements for alcohol, totaling $765, was a classification error and management oversight. The Fiscal Administrator allocated the purchases directly to LSC and the Executive Director did not catch the error in her review of the supporting documentation for both purchases. She approved them even though the Accounting Guide stipulates that costs of alcohol are not allowable as a charge to LSC.

Inadequately Supported Costs

NLS did not provide sufficient supporting documentation for five disbursements. NLS used $728 in LSC funds to pay for the expenditures, which included:

- three disbursements, totaling $599, for employee travel reimbursements; and
- two disbursements, totaling $129, for cellphone reimbursements.

NLS could not provide adequate documentation to substantiate employee travel reimbursements because the existing policy did not require employees to submit sufficient evidence of miles traveled. Similarly, NLS did not have a policy or signed agreement with employees in place regarding cellphone reimbursements. Without a policy or agreement, the OIG was unable to determine whether the expenditures were reasonable and necessary.

The OIG questions 16 disbursements, for which the grantee paid $1,375 with LSC funds, which were unallowable or insufficiently supported per 45 CFR § 1630.3. This includes all 14 unallowable disbursements and two inadequately supported cellphone reimbursements. The OIG will refer the questioned costs to LSC management for review and action.

Improper Approval

The grantee's Board of Directors did not approve two disbursements of LSC funds, each in excess of $5,000, in accordance with the grantee's internal written procedures. The total amount paid with LSC funds was $13,828 and included:

- one disbursement of $6,600 for an annual membership to and related services from an online resource for legal aid and pro bono attorneys; and
- one disbursement, totaling $7,228, for a luncheon, hosted by NLS.

Recommendations: The Executive Director should:

Recommendation 1: ensure that NLS abides by Section III C 1, Cash Disbursements Policies of the Accounting Manual or modify the policy to prohibit disbursing LSC funds for purposes prohibited by the Accounting Guide and LSC regulations including alcohol, flowers, and late fees. Grantee management should communicate the policies to the entire staff.

Recommendation 2: adhere to established policies for purchases in excess of $5,000 and obtain approval from the Board of Directors as required by the grantee's Accounting Manual and LSC regulations.

Recommendation 3: develop a written policy governing reimbursements for business use of personal cell phones. The policy should require employees to sign a written agreement and should stipulate that the grantee retain the agreement to substantiate reimbursement transactions.

Recommendation 4: enforce procedures that require sufficient supporting documentation, prior to approval, for all expenditures.

COST ALLOCATION

Generally, the cost allocation methodology used by NLS appeared reasonable, except that it did not include a provision for allocating indirect costs prohibited by LSC regulations. The grantee allocated indirect costs between locations and grants based on direct labor hours. The OIG noted that NLS used LSC funds to pay for expenses prohibited by LSC regulations because of the flaw in the design of the cost allocation methodology.

In addition, the written policy was outdated. Grantee management changed the cost allocation methodology as of January 1, 2013, but did not revise its Accounting Manual to correspond to actual practice.

NLS allocates costs by:

> fund – unrestricted federal funds, restricted federal funds, restricted non-federal funds, or
> property – location, grant, and expense type.

Costs that are directly attributable to a specific funding source are debited directly to the appropriate grant. Indirect expenses, which are not attributable to a specific funding source, are debited to grant code 99, a generic cost pool. At the end of each month, the Fiscal Administrator allocates the indirect costs accumulated in grant code 99 to funding sources based on the cost allocation formula. The current methodology does not include a provision for allocating indirect costs prohibited by LSC regulations to funding sources other than LSC. The grantee's written cost allocation policy, outlined in its Accounting Manual, needed to be enhanced to include such a mechanism.

In addition, grantee management made two changes to the cost allocation methodology as of January 1, 2013, but did not revise the Accounting Manual correspondingly. First, the Fiscal Administrator altered slightly the method for allocating administrative labor costs between locations. Second, the Fiscal Administrator created grant code 98, a generic cost pool for indirect labor expenses. Similar to grant code 99, NLS allocated the charges that accumulated in grant code 98 to the appropriate funding sources at the end of each month. The cost allocation policies contained in the grantee's Accounting Manual did not reflect these changes.

The cause of the flaw in the cost allocation methodology and discrepancy between the current practice and written policy was a management oversight.

A flawed cost allocation methodology prevents management and stakeholders from fairly assessing the total cost of activities. Additionally, funds designated for specific purposes may be misused.

Recommendations: The Executive Director should:

Recommendation 5: develop a written policy for allocating indirect costs that are prohibited by LSC regulations to funding sources other than LSC.

Recommendation 6: ensure written policies and procedures for cost allocation are updated to fully describe the process as practiced by the program. These policies and procedures should address the requirements of 45 CFR Part 1630 and LSC's Accounting Guide.

Recommendation 7: adhere to written policies and procedures for cost allocation.

CONTRACTING

The grantee's contracting policies, contained in the Accounting Manual were missing critical elements required by LSC's *Fundamental Criteria*. The policies did not address in sufficient detail the following areas.

- Securing various types of contracts
- Dollar thresholds
- Competition requirements
- Approval authority
- Documentation requirements
- Executing contracts that deviate from standard procedures, such as sole-source procurement
- Modifying contracts

Although the Accounting Manual did not sufficiently address policies for contracting, it does designate responsibility for approving purchases over $5,000 to the grantee's Board of Directors. The OIG found two instances, both dated November 1, 2013, of purchases exceeding the $5,000 threshold for which we did not find evidence of Board approval.[2]

In addition, NLS management stated that they secured three competitive bids for purchases of goods and services over $500. However, this policy was not documented in the grantee's Accounting Manual. The OIG examined the supporting documentation for four (4) transactions that exceeded the $500 threshold and did not find evidence of competitive bidding.

Weak contracting practices can result in waste of scare funds and subject grantees to questioned cost proceedings.

Recommendations: The Executive Director should:

Recommendation 8: ensure written policies and procedures for contracting address all of the elements required by LSC's *Fundamental Criteria.*

Recommendation 9: train staff to adhere to written policies and procedures for contracting.

EMPLOYEE BENEFITS

NLS had internal controls in place regarding employee benefits, but did not always adhere to the established controls. The grantee had written benefit policies, but

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[2] The OIG expanded the scope of the audit, per generally accepted government auditing standards, to include select transactions dated after September 30, 2013.

management overrode the written policies, deviating from the requirements outlined in Nevada Legal Services, Inc., Personnel Policies and Procedures Manual (Personnel Policies and Procedures Manual).

The OIG noted two instances where the Executive Director granted benefits to employees that deviated from established written policy. First, the grantee's Personnel Policies and Procedures Manual stipulates that permanent, part-time, employees that work more than twenty-eight (28) hours per week are eligible for group medical coverage, dental, and life insurance. The OIG found that a part-time employee, who worked fewer than 28 hours per week, received this group medical coverage, dental, and life insurance. The Executive Director explained that she granted the exception as a retention incentive.

In the second instance, the Executive Director authorized a salary advance in an amount that exceeded the total value of vacation leave that the employee had accrued.

The OIG noted a discrepancy between the grantee's salary advance policies outlined in the Personnel Policies and Procedures Manual and the policy management explained to us as operating in practice. The written policy contained in the Personnel Policies and Procedures Manual detailed that a salary advance could not exceed the amount of pay the employee would earn in two pay periods. However, we were told by staff that an additional policy existed regarding the dollar amount of salary advances. In addition to not exceeding two pay periods' worth of salary or wages, salary advances could not exceed the dollar amount of an employee's accrued vacation. The Salary Advance Request form used by NLS stated this policy. Management explained that the policy stated on the Salary Advance Request form reflected current practice. Regardless, the Executive Director made an exception and approved a salary advance that exceeded the dollar amount of an employee's accrued vacation. The dollar amount of the employee's accrued leave was $1,554, but the amount of the salary advance was $2,400.

When benefit policies are not clear and complete and when management deviates from the established written policy, the grantee may not apply benefits, both in appearance and fact, equitably.

Recommendations: The Executive Director should:

Recommendation 10: update written benefits policies and include language that allows management to grant exceptions to benefits policies, at their discretion, to accommodate organizational needs.

FIXED AND PHYSICAL ASSETS

The grantee's written policies and procedures regarding fixed assets are in accordance with the *Fundamental Criteria* contained in the Accounting Guide. However, NLS did not maintain adequate internal controls over fixed assets (*i.e.,* assets with a purchase cost of $5,000 or greater) or physical assets (*i.e.,* equipment valued below the $5,000 threshold for capitalization, but easily misused or misappropriated) in practice. Management explained that they performed annual inventories of fixed and physical assets to property records. However, the grantee did not retain sufficient evidence to substantiate that they had performed an inventory in 2012 and reconciled the results to the property records. Without adequate evidence, the OIG could not confirm that management actually performed the inventory.

In addition, property records, retained by NLS management, for physical assets were missing key recordkeeping elements required by the Accounting Guide. These include:

- source of funds used for acquisition;
- inventory control number;
- acquisition date;
- cost;
- location of asset;
- useful life; and
- date of disposal and sales price.

Management was unaware of the requirements outlined in the Accounting Guide. This was a proximate cause of the weaknesses in internal controls over fixed and physical assets.

Properly accounting for fixed and physical assets enables the grantee to safeguard its assets, fully account for the assets purchased and support reconciliations so that property asset balances are accurate.

Recommendations: The Executive Director should:

Recommendation 11: ensure the grantee documents in writing the results of physical inventory counts and reconciliations of inventory to property subsidiary records and the General Ledger.

Recommendation 12: update the property records to include all fields required by LSC's *Fundamental Criteria*.

CREDIT CARDS

The grantee did not have adequate internal controls in place governing the use and issuance of credit cards.

NLS did not have a written policy outlining acceptable uses of credit cards. The grantee's Accounting Manual stipulated that management must approve all charges but did not detail the types of purchases that cardholders were authorized to make with the credit cards. Of the 14 unallowable disbursements, totaling approximately $1,246, noted previously, three, totaling $781, were charged to NLS credit cards.[3]

Additionally, the grantee did not keep adequate records pertaining to credit cards issued to staff members. Management did not require employees, to whom the grantee issued credit cards, to sign acknowledgements of receipt. The Fiscal Administrator also did not record the date on which the grantee issued credit cards to cardholders.

Properly controlling the use and issuance of credit cards through written policies and sound recordkeeping practices reduces the potential for misuse and protects the grantee's limited assets.

Recommendations: The Executive Director should:

Recommendation 13: strengthen the written policies contained in the grantee's Accounting Manual that govern credit card usage. The policies should clearly delineate acceptable uses of credit cards and standards for recordkeeping including a provision requiring the Fiscal Administrator to document the date on which the grantee issues credit cards to staff.

Recommendation 14: require staff to sign an acknowledgement of receipt of credit cards and require the Fiscal Administrator to retain the acknowledgement forms in credit card files.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management disagreed with the unallowable costs section of the disbursement finding and recommendations in the report. The grantee stated that the coding of one disbursement for alcohol to LSC was a typographical error. A second disbursement for the purchase of alcohol was due to an error on the invoice submitted by the vendor. Grantee management explained that LSC funds were not used for the first purchase of alcohol and that they requested that the vendor reimburse Nevada Legal Services for the cost of the second purchase of alcohol. Grantee management stated that in the future, staff approving requisitions will pay close attention each time a requisition is approved.

Grantee management stated that the expenditures for the Costco membership and flowers were for legitimate business purposes. They stated that NLS incurred late fees on a few bills during 2012 but did not allocate those late fees to LSC funding.

Regarding the costs OIG found were inadequately supported, NLS management stated that the checks reviewed by the OIG contain all the appropriate documentation as required by NLS's written policies.

[3] These transactions included two disbursements, totaling $222, for flowers and one disbursement of $559 for alcohol.

Grantee management stated that it did not have a written agreement with the employee for whom NLS pays a portion of the employee's private cell phone bill. According to NLS, it is in the process of developing a written policy for such expenses and the policy will be ready for adoption by the Board of Directors at their September meeting.

For the costs that the OIG found were improperly approved, NLS management stated that the Board of Directors approved both. Grantee management explained that the $6,600 disbursement is the annual payment of the fee for the grantee's NevadaLawHelp.org website. NLS pays a yearly fee in order to have the LSC required statewide website. Grantee management stated that the disbursement is a known annual technology cost and has been included in NLS' annual budget for over a decade. The Board of Directors approved the cost when it approved the annual budget.

In addition, NLS explained that the second disbursement is the cost for the annual pro bono awards luncheon. NLS stated that it is a known annual expense and is included in the annual budget that is approved by the Board of Directors.

Grantee management stated that NLS has drafted a revised cost allocation method. If approved, the Board of Directors will adopt it at its September meeting.

Grantee management stated the work to secure the vendor for entertainment at the grantee's annual pro bono awards luncheon in Reno was performed five years ago. At the time, grantee management found only one source of entertainment that was appropriate. The contract was secured five years ago and had not changed since then. The second and third contract costs, grantee management stated, were for venues for their annual pro bono awards luncheon in Reno and Las Vegas. When the luncheon began five years ago, NLS contacted several possible venues in both locations for quotes. The contract with the vendor for the Reno luncheon has not changed in five years. For the Las Vegas luncheon, the vendor notified NLS that its costs were increasing three years ago. NLS searched for a new vendor at that time and accepted an offer from a new vendor where the Las Vegas luncheon has been held for the past three years. The contract has not changed over those three years. Grantee management stated that NLS would search for new venues and ask for quotes for services if the cost of either venue should change.

The final contract, for the grantee's NevadaLawHelp.org website, was secured over a decade ago and predates anyone who is currently at NLS, grantee management explained. Current grantee management does not know why that program was specifically chosen nor the process used to secure the contract. The annual fee associated with the program has been part of the NLS annual budget since then.

Grantee management stated that they deviated from written employee benefits policies in an effort to retain qualified staff through a job sharing arrangement. NLS is in the process of updating their Accounting Manual to outline written policies regarding job sharing. Grantee management stated that its manual does not specifically grant the

Executive Director the ability to waive any policy under certain circumstances, such as granting salary advances that do not adhere to the written policy, but the manual will be updated to reflect that the Executive Director has the authority to grant such waivers.

Grantee management stated that fixed and physical asset inventories contain the information required by the NLS Accounting Manual and are reconciled to the General Ledger.

NLS responded that the NLS Accounting Manual does not detail the use for which company credit cards can be used. This will be included in the update of the NLS Accounting Manual. Grantee management further stated that NLS does not have a form that an employee receiving a credit card signs acknowledging receipt of the credit card, but will draft one to include in the Accounting Manual.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG has reviewed the grantee's comments on the draft report findings and recommendations.

In its response to the disbursement finding regarding unallowable costs, NLS management did not address Recommendation 1. The OIG disagrees with grantee management's response regarding the Costco membership and flowers. Disbursements for flowers are not allocable to LSC even if they are legitimate business expenses. Grantee management stated in their response that the disbursements to Costco were for business memberships for two employees who purchase office supplies. They stated that the business membership resulted in cost savings. The OIG disagrees with grantee management's response. The annual fee for a Costco business membership is $55.00. Up to six additional cardholders may be added to the membership for $55.00 each and up to six household members may be added for free. The invoices we examined showed NLS added up to twelve employees to the Costco membership. Some employees reimbursed NLS in full for the membership while others did not. The OIG questioned only the portion of the disbursements for Costco memberships for which NLS did not provide supporting documentation showing that the grantee was reimbursed in full. The OIG also disagrees with grantee management's response regarding late fees. Grantee management provided additional documentation in their response, but it was not for the transactions cited in the report. Recommendation 1 will remain open until the OIG has been notified in writing that NLS will abide by Section III C 1, Cash Disbursements Policies of the Accounting Manual or the policy to prohibit disbursing LSC funds for purposes prohibited by the Accounting Guide and LSC regulations including alcohol, flowers, and late fees has been modified. Additionally, NLS management must notify the OIG in writing when meetings with staff to discuss adherence to accounting policies and procedures have been completed.

The grantee addressed Recommendation 2 by providing explanation of the approvals obtained by the Board of Directors for purchases in excess of $5,000. However, best practices for contracting include seeking competitive bids each time a contract is solicited and explicitly seeking approval by the Board of Directors each time a contract is solicited, rather than simply having the disbursements approved as a line item in the annual budget.

The grantee partially addressed Recommendations 3 and 4. However, the OIG noted in the report that the grantee's written policies for substantiating employee travel reimbursements are not adequate. To fully address Recommendation 4, the grantee needs to revise its existing policy to require employees to submit evidence of miles traveled, e.g., by providing the beginning and ending points of each trip and total mileage traveled. The recommendations will remain open until the OIG is notified in writing that the applicable written policies have been updated and added to the Accounting Manual.

The grantee has partially addressed Recommendations 5, 6, and 7. The recommendations will remain open until the OIG is notified in writing that the revised cost allocation methodology in accordance with LSC requirements has been adopted by the Board of Directors and fully implemented.

Recommendations 8 and 9 have not been addressed. They will remain open until the grantee revises its written policies and procedures for contracting to address all the elements required by LSC's *Fundamental Criteria* and the OIG is notified in writing of the revisions to the applicable policies.

The grantee has partially addressed Recommendation 10. The recommendation will remain open until the OIG has been notified in writing that the applicable policies have been adopted by the Board of Directors and fully implemented.

The grantee has addressed Recommendations 11 and 12 by completing and providing the results of the office inventory for 2013 to the OIG. The OIG considers the recommendations closed.

The grantee has partially addressed Recommendations 13 and 14 by proposing updates to the Accounting Manual that include details on the acceptable uses of credit cards and by drafting a form to include in the Accounting Manual that employees will sign to acknowledge receipt of a credit card. The recommendations will remain open until the OIG is notified in writing that the updates have been adopted by the Board of Directors and fully implemented.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Cash disbursements
- Credit card usage
- Cost allocation
- Contracting
- Property and equipment
- Derivative income
- Employee benefits
- Internal management reporting and budgeting

To obtain an understanding of the internal controls over these areas, we reviewed grantee policies and procedures including manuals, guidelines, memoranda, and directives setting forth current grantee practices. We interviewed grantee officials to obtain an understanding of the internal control framework and to assess the level of awareness and knowledge of management and staff of the processes in place. To review and evaluate internal controls, we compared the grantee's internal control system and processes 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 was 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 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.

To test the appropriateness of expenditures and to test for the existence of adequate supporting documentation, we reviewed disbursements from a judgmentally selected sample of employee and vendor files. We selected 82 transactions from the period January 1, 2012 through September 30, 2013 and three transactions dated outside the audit scope. The 82 transactions totaled $170,562, and represented approximately 3 percent of the $5,952,703 disbursed for expenses other than payroll, during the period January 1, 2012 through September 30, 2013. To assess the appropriateness of expenditures, we reviewed invoices, vendor lists, and traced the expenditures to the general ledger. We evaluated the appropriateness of the expenditures on the basis of grant agreements, applicable laws and regulations, and LSC policy guidance.

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.

We reviewed controls over salary advances by examining personnel policies and practices and by testing a judgmentally selected sample of employee reimbursements as part of the disbursements testing. To assess the salary advance process, we reviewed salary advance requests for appropriate approvals and compliance with the grantee's internal standards. We reviewed them to determine whether the salary advances exceeded two pay periods' worth of salary and/or exceeded the dollar amount of an employee's accrued vacation. We examined the accounting records showing the amount of salary paid in advance and individual pay statements showing the amounts deducted towards the repayment of the salary advance.

We reviewed the grantee's cost allocation process, for 2012 and 2013, to determine if it was in compliance the Accounting Guide. We compared the cost allocation procedures actually practiced by the grantee to the grantee's written policies and procedures. We selected two months within the audit scope, November 2012 and June 2013, and reviewed documentation supporting cost allocations for those months using the information provided by the grantee. We reviewed the subsequent journal entries posted by the grantee to the general ledger to allocate costs for the two months.

We reviewed controls over derivative income by interviewing management, identifying current grantee practices, reviewing the written policies contained in the grantee's Accounting Manual, and examining entries to the accounting system documenting receipt and allocation of derivative income.

The OIG conducted on-site fieldwork from November 11, 2013 through November 15, 2013. Our work was conducted at the grantee's central administrative office in Las Vegas, Nevada and at LSC headquarters in Washington, DC. We reviewed documents pertaining primarily to the period January 1, 2012 through September 30, 2013. We expanded the scope to examine specific disbursement transactions through November 1, 2013.

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.

NEVADA LEGAL SERVICES
INCORPORATED

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July 7, 2014

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

Re: Nevada Legal Services' Revised Response to the Draft Audit Report

Dear Mr. Seeba:

This letter will serve as Nevada Legal Services' revised response to your draft audit report dated May 13, 2014. We are grateful for the extension of time granted to us to reply to the report. We will go through the audit findings section by section and provide a response.

Disbursements:

Unallowable Costs

The Report states that NLS used LSC funds to pay 14 disbursements for unallowable purposes. NLS respectfully disagrees with the findings.

The first disbursement for the purchase of alcohol (EFT0081) was the purchase of wine that was used as door prizes for the annual pro bono award luncheons in Reno and Las Vegas. The coding was simply a typographical error that was not caught. The receipt for the purchase clearly states that non-LSC funds were to be used for the purchase. Please see the receipt attached as Exhibit 1.

The second disbursement for the purchase of alcohol was an error. As was explained during the OIG visit, the Peppermill donates bottles of wine that are served to the guests during our pro bono award luncheon. What NLS is responsible for paying is the waiter service. The wine itself is not supposed to be included on the invoice. The invoice should look like the one that the OIG reviewed for the 2013 luncheon at the Peppermill. This error was not caught by the Peppermill before the invoice was sent out and was not caught by NLS when the invoice was paid. NLS has requested that the Peppermill reimburse NLS for the $206 and the Peppermill has agreed to do so. Then no LSC funds will have been used for this purpose.

For both of the above matters, all we can do is say that the staff making the approvals will pay close attention each time a requisition is approved, especially when the stack of requisitions is large. The topic has been added to the agenda for our Management Team meeting on August 2nd.

The $153 for the Costco memberships is a legitimate business expense. NLS uses Costco to purchase a goodly amount of our office supplies. In order to receive the least expensive membership for the purchase of office supplies, Costco itself suggested that NLS simply pay for individual memberships for the staff members who have responsibility for purchasing office supplies. NLS followed this advice and does purchase an individual membership for a staff member in the Reno office and a staff member in the Las Vegas office whose responsibilities include the purchasing of office supplies. The cost savings over purchasing a business membership is quite substantial. The costs for those two memberships were coded to Grant Code 99, the general allocation code. The costs were allocated to all of our grant funds, including a portion to LSC funds as the purchase of office supplies is a legitimate business expense.

NLS did incur late fees on a few bills during 2012. The reason for the late fees was that NLS had two grant funders that were irresponsibly late in making disbursements after NLS submitted our monthly reports and invoices. One funder did not pay NLS its first payment until seven months into the contract, after NLS had to threaten to bring suit against them. Between the cuts in federal funding due to sequestration and the two funding sources that were late in their reimbursements, NLS was having a cash flow issue in 2012. NLS paid our bills when we had the cash in the bank. That resulted in some late fees. However, NLS did not allocate those late fees to LSC funding. The late fees in all cases were allocated to Grant Code 30 (county filing fees), which is unrestricted, non-federal funding. Please see the backup documentation attached as Exhibit 2.

The disbursements for flowers did have a legitimate business purpose. Two NLS employees lost immediate family members during the year, and NLS sent flowers to the funerals. Other NLS employees were hospitalized after serious surgery and NLS sent them flowers. A normal cost of doing business is the need to maintain morale and these small gestures of caring mean a great deal to the staff. NLS did charge three of the flower purchases to LSC funds, but not the fourth one. The fourth purchase was charged to Grant Code 12, which is unrestricted non-federal funds. NLS has not made such purchases with LSC funds since then. The Board of Directors does question why such purchases are not considered allowable uses of LSC funding. It is a normal cost of business to make such purchases for staff members.

Inadequately Supported Costs

NLS' travel policy for staff does require employees to submit sufficient evidence of travel. Please see the copies of the relevant portion of the NLS Manual attached as Exhibit 3. The staff member is required to submit three documents: the Travel Request Form, the Travel Reimbursement form, and, in cases where the staff member is requesting reimbursement of mileage, the Mileage Form. The last form requires the staff member to state the purpose of the travel, the case number where applicable, and the odometer readings. NLS used the template provided by the OIG a few years ago for the Mileage Form. The checks that were reviewed by the OIG do contain all of the appropriate documentation as required by our written policies. Please see the backup documentation attached as Exhibit 4.

NLS did not have a written agreement with the employee for whom NLS pays a portion of the employee's private cell phone bill. The employee uses his cell phone for work purposes most of the time, including the nightly and weekly backup of our electronic files. NLS is in the processing of developing a written policy for such expenses and it will be ready for adoption by the Board of Directors at their September meeting.

Improper Approval

The NLS Board of Directors did approve both of these disbursements. The $6,600 disbursement is the annual payments of the fee for our NevadaLawHelp.org website. The Legal Services Corporation requires NLS to have and maintain a statewide website providing legal information for the client community. NLS chose ProBono.Net's program as the template and server storage for the website. Our NevadaLawHelp.org is not located on our server system. It is located on the ProBono.Net servers and the servers are maintained by ProBono.Net. NLS pays a yearly fee in order to have the required statewide website. This is a known annual technology cost and is included in the technology line items in NLS' annual budget. It has been for over a decade. The Board of Directors approved this cost when it approved the annual budget. All known annual costs (such as office rent, mortgage payments, technology costs, case management system fee) are included in our annual budget that is approved by the Board of Directors each year.

The second disbursement is the cost for our annual pro bono awards luncheon at the Peppermill Mill Resort. The costs for the two annual awards luncheons are also known annual costs and are included in the annual budget. This disbursement was approved when the Board of Directors approved the annual budget.

Cost Allocation:

NLS has drafted a revised cost allocation method. The draft is attached as Exhibit 5 for your review. If approved, the revised cost allocation method will be adopted by the Board of Directors at its September meeting.

Contracting:

This finding questions the lack of bidding for services over $500 as per the NLS policy. One is the cost for the Reno Jazz Orchestra. This cost is for the entertainment at our annual pro bono awards luncheon in Reno. When NLS first established the annual pro bono awards luncheons five years ago, we decided that we wanted to include some light entertainment for the guests as they were checking in and milling about until the luncheon began. In Reno, NLS searched for possible entertainers and we found only one source that was appropriate (there were many rock bands and DJs that were not appropriate for what NLS wanted). The one source was the Reno Jazz Orchestra. We have used the Reno Jazz Orchestra every year. The work to find the appropriate vendor for this service was done five years ago and the contract with the Reno Jazz Orchestra has not changed in five years.

The second and third costs are the costs for the venues for our annual pro bono awards luncheon in Reno. Again, five years ago when NLS first established our pro bono awards luncheon, NLS contacted several possible venues and asked for quotes. The Peppermill offered the best deal for the greatest amount of service. NLS has continued with the Peppermill as the contract has not changed in five years. NLS did the same thing with the Las Vegas pro bono awards luncheon. When it began five years ago, NLS contacted several possible venues for quotes and settled on the Springs Preserve. At the beginning of the third year, the Springs Preserve notified NLS that its costs were increasing and our awards luncheon would cost nearly triple the amount of the year before. NLS searched for a new venue and accepted the quote offered by the Las Vegas Country Club, where the awards luncheon has been held for the past three years. If either venue's costs should change, NLS will again search for a new venue and ask for quotes for services and will decide on a contract that is the least cost for the best services.

The final contract is the $6,600 fee that NLS pays for the housing and maintenance of our NevadaLawHelp.org statewide website. When the Legal Services Corporation first required that each program be part of a statewide website, the Corporation gave programs three options: choose one of the recommended programs (ProBono.net or Kaivo) or create your own. Nevada Legal Services chose to go with ProBono.net. That decision was made over a decade ago and predates anyone who is currently at NLS. We do not know why that program specifically was chosen nor do we know what process was used. However, since the program was chosen, the annual fee for the maintenance of the program has been a part of the NLS annual budget, as explained above.

Employee Benefits:

One of the new employment trends is job sharing (where two people request that they share one full-time position between the two of them). In the past year, NLS has been approached twice about the possibility of job sharing two open positions. In both cases, NLS wanted to hire the two employees requesting the job sharing arrangement as the employees were the most qualified for the position and were well respected by the staff. IN the instance referred to by the OIG, one if the employees was a long-time NLS employee with a great deal of expertise that NLS wanted to keep on staff and the job sharing proposal she suggested was a way to keep that expertise. NLS and the two employees for each position worked out the job sharing arrangement, including the hours each was to work and specific duties under the position and which employee would get the insurance benefits that came with the full-time position. NLS does not have a written policy regarding job sharing positions. NLS is in the process of updating our manual to reflect the growing employment trends. The policy will be ready for the Board of Directors to adopt at its September meeting.

The second incident was where the Executive Director granted a written waiver to the policy that requires a staff person to have enough accrued vacation to cover the cost of a salary advance for a salary advance to be granted. In the incident in question, the Executive Director discussed the request for a salary advance with the employee, knew the circumstances for the request, knew that the employee would have earned enough accrued vacation to cover the salary advance within the next month, and knew the employee would not leave before the salary advance was paid in full. The Executive Director granted the waiver and approved the salary advance. The NLS manual does not specifically grant the Executive Director the ability to waive any policy under certain circumstances. Everyone has assumed that the power to do so exists. This will be added to the updates that NLS is making to its manual.

Fixed and Physical Assets:

NLS has very few fixed assets because of the $5,000 fixed asset limit. There are very few assets that NLS purchases that exceed the $5,000 threshold for capitalization. For the fixed assets, NLS does maintain the required inventory with the information regarding source of funds used, inventory control number, etc. Physical assets do not require the same documentation that the fixed assets do under the NLS accounting manual. NLS' inventory of physical assets includes a description of the asset, the inventory or tag number of the asset, its location, and if the asset was disposed of during the year, the date of disposal.

At the time of the OIG audit, the Las Vegas and Elko offices had completed their inventories of both fixed and physical assets. The Reno office had not yet completed their inventory. The Reno office inventory was completed after the OIG audit and the entire inventory was provided to the OIG. NLS completed its 2014 inventory and it is attached as Exhibit 6. The fixed and physical assets inventories do contain the information required by the NLS manual and are reconciled to the General Ledger.

Credit Cards:

NLS' manual does not detail the use for which company credit cards can be used. This will be included in the updating of the NLS manual that is taking place. However, NLS believes that the specific uses of the credit cards that the OIG points out were legitimate uses of the credit card and were addressed above.

NLS does not have a form that an employee receiving a credit card signs acknowledging receipt of the credit card and will draft one to include in our Accounting Manual. What NLS has done in the past was to physically hand the credit card to the employees that are located in the Las Vegas office. For the employees in the northern offices, NLS sends the employee an e-mail informing the employee that the credit card is in the mail and the employee responds when the credit card arrives. There has always been knowledge by the accounting staff that the staff member did receive the credit cards.

If you require any further information from NLS, please let me know. We'd be happy to supply it for you.

Sincerely,

AnnaMarie Johnson

AnnaMarie Johnson
Executive Director