Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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January 27, 2015

Ms. Adrienne Worthy
Executive Director
Legal Aid of West Virginia
922 Quarrier Street
Charleston, WV 25301

Dear Ms. Worthy:

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

The OIG considers the proposed actions to address Recommendations 1 - 7, 9, 11, 12, 14, 18, 19 and 20 as responsive. Recommendations 1, 2, 3, 5, 6, 7, 14, 18 and 20 will remain open until your Board of Directors approves the revised Accounting Manual and the OIG receives written notification thereof. The other recommendations; 4, 9, 11, 12 and 19; will remain open until the OIG is notified in writing that the proposed action has been completed or implemented. Since the actions implemented have fully addressed Recommendations 8, 10, 13, 15, and 17, we consider them as closed.

The OIG does not consider your comment to Recommendation 16 responsive and is referring it to LSC management for resolution. We noted a physical inventory is performed by the grantee; however, we noticed the property records are not updated after the physical inventory. Grantee management's response for Recommendation 16 only states this is a current practice; the response does not include the procedures to be performed at this time to correct the specific issue.

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

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

LEGAL AID OF WEST VIRGINIA, INC

RNO 449041

Report No. AU 15-02

January 2015

www.oig.lsc.gov

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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 Legal Aid of West Virginia, Inc. (LAWV or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Charleston, WV 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

LAWV was formed as of January 1, 2002 from the merger of West Virginia Legal Services Plan, Inc. and Appalachian Legal Services, Inc. LAWV represents low income individuals in civil legal matters, provides regional long-term care ombudsmen services throughout the State of West Virginia, assists victims of domestic violence and provides advocacy services to the residents of the community and in-patient behavioral health facilities operated by the State of West Virginia.

According to the audited financial statements for the grantee's year ended December 31, 2013, approximately 74 percent of the grantee's total support funding was provided by two funding sources: LSC and the State of West Virginia. LAWV received $2,506,173 from LSC and $4,824,216 from the state. In addition, the grantee received $449,407 from other grantors and $873,597 from various local and private sources.

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 select 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, employee benefits and internal reporting and budgeting.

While many of LAWV's controls were adequately designed and properly implemented as the controls related to specific grantee operations and oversight, some controls need to be strengthened while other controls need to be formalized in writing.

DERIVATIVE INCOME

The grantee's current practices involving derivative income were not in accordance with the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide. During the period of review, LAWV did not allocate some attorney fees to the related funding sources. In addition, the financial manual does not document a methodology on how to record and allocate derivative income.

Written Policies

Our review of the grantee's Financial Policies and Procedures Manual (Financial Manual) revealed that there were no written policies and procedures in place for recording and allocating derivative income to its various funding sources. The grantee received derivative income in the form of interest income and attorneys' fees. According to LAWV management, a funding code is assigned to record attorneys' fees in the general ledger once the funds are received. The funding code assigned is usually the last funding code staff charged time to in the grantee's timekeeping system. Although the timekeeping system does track attorneys' time based on funding codes for each case, grantee management explained that the reason for recording attorneys' fees this way is because funding codes may be closed out prior to receiving the attorneys' fees.

45 CFR §1630.12 states:

> Derivative income resulting from an activity supported in whole or in part with funds provided by the Corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the

> amount of Corporation funds expended bears to the total amount expended by the recipient to support the activity.

Without detailed written procedures, there could be a lack of transparency and consistency in the application of the methodology especially in cases of staff turnover. Documented policies and procedures detail the process steps, document the design of controls, communicate the controls to the staff, and help the grantee ensure that proper controls are followed.

Attorneys' Fees

LAWV did not allocate attorneys' fees income in accordance with 45 CFR §1609.4 (a). According to the general ledger review, the grantee received approximately $165,809 in attorneys' fees between January 1, 2013 and May 31, 2014. A portion was recorded as LSC fee for service at $1,200. The OIG reviewed a sample of six cases involving attorneys' fees that were included in the general ledger. The revenue for these six cases totaled $47,490. For four of the six cases, LAWV's timekeeping system reports showed that the cases were fully or partially funded by LSC. Based on the hourly information provided to us in these reports, we calculated that 8 percent of the hours were charged to LSC in the timekeeping system. As a result, based on the six cases in our sample, $3,842 should have been allocated to LSC. As attorneys' fees were not properly allocated to LSC based on its apportioned share of time, LAWV is not in compliance with 45 CFR §1609.4.

45 CFR §1609.4 (a) states:

> Attorneys' fees received by a recipient for representation supported in whole or in part with funds provided by the Corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of Corporation funds expended bears to the total amount expended by the recipient to support the representation.

Properly recording attorneys' fees allows LSC to be allocated its apportioned share of income, which in turn can be used to provide legal services in accordance with LSC requirements.

Since attorneys' fees in our sample were not allocated to the related funding sources and LAWV does not currently follow processes within the meaning of 45 CFR §1609.4, the OIG is questioning $3,842 of attorneys' fees. The OIG will refer the questioned costs to LSC management for review and action.

Recommendations: The Executive Director should:

Recommendation 1: formalize written policies and procedures for recording and allocating derivative income in accordance with the LSC Accounting Guide.

Recommendation 2: develop written policies and procedures to ensure that the requirements of 45 CFR §1609.4(a) related to the recording of income derived from attorneys' fees is fully implemented.

COST ALLOCATION

Based on a comparison of the policies outlined in the grantee's Cost Allocation Statement, LSC regulation 45 CFR §1630.3, and the Accounting Guide, LAWV's cost allocation written methodology appears reasonable. However, the OIG noted the allocation methodology for contract services is limited in scope. It addresses specifically the cost allocation methodology for audit services and contract attorneys; it does not address the cost allocation methodology for the other broad range of contracts to which LAWV is party. Additionally, the OIG noted the cumulative effect of LAWV allocation of indirect salaries and wages is potentially misstating expenses, revenue and accounts receivable.

Cost Allocation Methodology

The OIG examined the detailed general ledger for accounts related to indirect costs and found there are ending balances in various fund accounts for 19999, 51199, 71350, 71325 and 96300. Additionally, the OIG noted the cumulative effect of the manner in which LAWV allocates Indirect Salaries and Wages is to potentially overstate expenses and revenue and misstate accounts receivable.

When incurred, LAWV charges indirect salaries and wages to fund L01, LSC Basic Field Grant and Cost Center 800, Indirect Cost Pool. To distribute the indirect salaries and wages across funding sources, LAWV makes a series of complex adjusting entries but does not ensure the accounts used for interfund transfers have zero balances at year-end. Per LAWV management, LAWV relies on its IPA to adjust account balances for inclusion in year-end financial reports. In an email, the Chief Financial Officer agreed with the OIG's assessment of the cumulative effect of the allocation of Indirect Salaries and Wages.

Written Policies

Overall, LAWV's written cost allocation methodology which uses direct salaries and wages as the base for allocating indirect costs appears reasonable. However, the OIG noted that procedures contained in the Cost Allocation Statement (CAS) are limited in scope and do not fully describe the methodology in place, which is quite complex. The CAS does not adequately outline policies for allocating indirect salaries and wages or contract service costs. It also does not specifically reference the distribution codes established by LAWV to allocate general office supplies, office occupancy and copying expenses.

The written policies contained in LAWV's CAS regarding Indirect Salaries and Wages are brief and do not address in sufficient detail the methodology for allocating indirect salaries and wages across funding sources. The actual methodology used by LAWV is complex and not adequately described in the CAS.

Section II.H, Contract Services, of LAWV's CAS states, "The cost of the annual audit is charged indirectly. The costs of contract attorneys are charged directly to the benefiting contract/grant." While the grantee's CAS addresses specifically the methodology for audit services and contract attorneys, it does not address the cost allocation methodology for the broad range of contracts to which LAWV is a party.

Additionally, the CAS states that general office supplies, office occupancy and copying expenses are charged on a "...per head basis and linked to individual funding sources." This is a reference to the distribution codes LAWV has in place to allocate these costs. LAWV should directly reference the distribution codes in the CAS.

Section 3-5.9 of the Accounting Guide states "...the allocation formula should be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO, and others, to easily understand, follow, and test the formula." Without detailed written procedures, there could be a lack of transparency and consistency in the application of the methodology especially in cases of staff turnover. Approved documented policies and procedures represent management's intentions on how processes are to be handled and also serve as a method to document the design of controls, communicate the controls to the staff and help the grantee ensure that proper controls are followed.

Improper Allocation

LAWV allocated to LSC the entire invoice amount for the annual cost of four maintenance contracts for videoconferencing equipment owned by LAWV. The costs included as maintenance totaled $14,562.45 for 2013. IT management explained the equipment is used for staff meetings, Board meetings, client interviews and task forces. With this information we determined the expense should be allocated across multiple funding sources as other costs are allocated, not just LSC.

45 CFR §1630.3 (f) states:

> Where a recipient has only one major function, i.e., the delivery of legal services to low-income clients, allocations of indirect costs may be a simplified allocation method, whereby total allowable indirect costs (net of applicable credits) are divided by an equitable distribution base and distributed to individual grant awards accordingly.

LAWV management noted the entire cost of the maintenance contract is allocated to LSC because some other funding sources do not allow such charges, however, the OIG notes that LAWV allocates other office expenses across multiple funding sources using the distribution codes.

Recommendations: The Executive Director should ensure that:

Recommendation 3: the cost allocation addresses the methodology for allocating costs associated with a comprehensive range of contract types, describes the methodology for allocating indirect salaries and wages and refers to the distribution codes that LAWV uses to allocate expenses;

Recommendation 4: the annual cost of maintenance contracts is allocated across funding sources according to LAWV's office distribution codes;

Recommendation 5: year-end fund accounts used for interfund transfers; including the expense, revenue and accounts receivable; have zero balances in the accounting system.

CONTRACTING

LAWV does not have specific written policies regarding contracting. The grantee's current practices for soliciting and awarding contracts were not in accordance with the *Fundamental Criteria* contained in the Accounting Guide. Specifically we found one contract missing, insufficient documentation and an incomplete contract list.

Written Policies

After a review of the various LAWV policies as well as interviews with grantee management, the OIG determined the grantee does not have written policies and procedures or adequate contracting practices in place. Per discussion with grantee management, LAWV did not have written contracting policies in place because of management oversight. The CFO stated that LAWV management realized prior to the audit that the grantee should have written contracting policies, but had not yet drafted or implemented such policies.

Section 3-4 of the Accounting Guide states that 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*. Fully documenting policies and procedures helps ensure that proper controls are followed, serves as a vehicle to communicate controls to all staff, and that staff members understand their roles and responsibilities.

Processes and Supporting Documentation

The OIG performed detailed testing of 10 contracts entered into by LAWV including property rental leases, personnel services and janitorial services. The total disbursements over the audit period for the 10 contract vendors tested were $278,116.21. Our testing of the ten LAWV contracts revealed the following:

- Ten contracts were not competitively bid;
- Ten contracts did not document the process used for each contract action;

- One contract was not complete as only the terms and conditions were provided;
- The effective dates of all 10 of the contracts were not documented on the official contract list maintained by LAWV;
- Two contracts did not have an effective date documented on the contracts themselves;
- Three were not included on the list of contracts provided by LAWV; and
- Two contracts did not have sufficient deliverables information.

The Accounting Guide, under Chapter 3-5.16, states the process used for each contract action should be fully documented and the documentation maintained in a central file. Any deviation from the approved contracting process should be fully documented, approved, and maintained in the contract file. In addition, the statement of work should be sufficiently detailed so contract deliverables can be identified and monitored to ensure the deliverables are completed. The type and dollar value of contracts requiring competition should be required by the policies of the grantee. Documents to support competition should be retained and kept with contract files. The required approval level (including items that need to be approved by LSC) should be established for each contract type and dollar threshold, including when the board of directors should be notified and/or give approval.

LAWV did not competitively bid contracts or justify sole source contracting due to the lack of management oversight. By not subjecting these contracts to competitive bidding and documenting the justification, it is not clear whether the grantee received the best price and service available for the money spent. The grantee stated that it realized prior to the audit that contracting policies should be in place, but had not yet drafted or implemented any policies. As a result, the grantee did not have any policies and procedures at the time of the audit that addressed when contracts should be competitively bid or when sole source justification is required.

Contracting is a high-risk area for potential abuse. If not properly conducted, weak contracting practices can result in a waste of scarce funds and subject the grantee's contracts to questions.

Recommendations: The Executive Director should:

Recommendation 6: formalize written policies and procedures for contracting in accordance with recommendations in the report and the *Fundamental Criteria*.

Recommendation 7: ensure that contracting practices adhere to LSC requirements to include: a) the documentation maintained is complete with the process used for each contract action; b) there is adequate support for competition or sole sourcing of the contract; and c) the documentation is maintained in a central file; and

Recommendation 8: ensure the official listing of contracts maintained is complete and sufficiently detailed; the approved contracting process is fully documented, approved and maintained in the contract file, and the statement of work is sufficiently detailed.

DISBURSEMENTS

Our audit found that internal controls over disbursements need to be strengthened. LAWV has adequate written policies and procedures in place for disbursements; however, our test of disbursements revealed some unallowable costs were allocated to LSC.

Of the 83 disbursements tested and valued at approximately $231,318, seven should not have been charged to LSC funding. Ensuring that costs are allowable and disbursements are appropriately approved helps to ensure that funds are only used for authorized purposes.

The OIG found seven unallowable transactions totaling $14,352.13 of which $5,093.83 was allocated to LSC:

- One disbursement totaling $10,453 for the Committee on Regional Training membership dues, of which $4,150.37 was allocated to LSC;
- Four disbursements totaling $363.46 to purchase flowers;
- One disbursement totaling $3,010.67 of which $55 was for a late lease payment fee that was allocated to LSC; and
- One disbursement totaling $525 was noted as expenses for an award dinner.

45 CFR Part 1630 provides that expenditures by a grantee be reasonable and necessary for the performance of the grant or contract and be adequately documented.

45 CFR Part 1627 provides that LSC funds may not be used to pay membership fees or dues to any private or nonprofit organization, whether on behalf of a recipient or individual, unless mandated by a governmental organization to engage in a profession.

Within the meaning of 45 CFR §1630.3, the OIG is questioning the cost of the seven unallowable disbursements totaling $5,093.83. The questioned costs will be referred to LSC management for review and action.

LAWV management stated the unallowable and unapproved disbursements might have been due to an oversight. In addition, the grantee alleged the personal transaction was reimbursed but support for the reimbursement was not provided.

Recommendation 9: The Executive Director should mandate that adequate supporting documentation is maintained for all expenditures to ensure LSC funds are used only for authorized purposes.

CREDIT CARDS

Internal controls over credit cards need to be strengthened. We discovered several weaknesses including inadequate support for transactions, transactions for personal items and cash advance fees charged to LSC.

LAWV's policies and practices over credit cards are mostly comparable to LSC's *Fundamental Criteria*; however, the policies do not include a set maximum dollar amount that can be charged to credit cards before prior authorization. Failure to set spending limits on credit card purchases may result in abuse and improper use of credit cards.

As a result of our testing, we found that all transactions were supported with receipts. However, we found that nine transactions either were unallowable and not in accordance with LSC laws and regulations or did not include the requisite approvals in accordance with LAWV's policies and procedures. The nine transactions totaling $1,853.27 included:

- Five transactions with personal use of the credit card amounting to $1,210.55;
- Two credit card fees as a result of cash advances to cover payroll overdrafts amounting to $42.72; and
- Two payments for membership dues to the Association of Fundraising Professionals amounting to $600.

45 CFR Part 1630 provides that expenditures by a grantee be reasonable and necessary for the performance of the grant or contract and be adequately documented. 45 CFR §1627.4 provides that grantees may not use LSC funds to pay dues to any private or nonprofit organization other than dues mandated as a requirement of practicing a profession by a governmental organization. Within the meaning of 45 CFR §1630.3 and 45 CFR §1627.4, the OIG is questioning the cost of four of the nine unallowable disbursements totaling $642.72 allocated to LSC. The questioned costs will be referred to LSC management for review and action. The five personal transactions charged to the credit card were reimbursed to LAWV.

There were 12 transactions over $100 totaling $17,839.30 related to employee expense reports that did not have the requisite approval. Failure to follow the purchase approval process may result in purchases made without the knowledge of appropriate management, at unacceptable prices or terms or for unauthorized uses.

LAWV management explained LAWV does not currently include or reconcile credit card transactions to employee related expense reports. Furthermore, LAWV management explained that supervisory approval is not mandatory for required employee training. For personal credit card use, LAWV agrees that personal use is prohibited and is stated in their policy. LAWV also had five instances of cash advance transfers to cover payroll overdrafts amounting to $13,806.45. Although these cash advance transactions were not charged to LSC funds, it is not a best practice to have payroll overdrafts i.e., payroll is a critical aspect of managing the program and its personnel. LAWV management explained that the grantee does not have a cash flow issue; it is more of an issue with the new employee and changes to their banking system. As a result of the cash advance transfers, LAWV was charged avoidable bank fees.

Recommendations: The Executive Director should address these issues by:

Recommendation 10: setting a spending limit on credit card purchases;

Recommendation 11: having employee travel related costs charged on credit cards included and reconciled with the employee expense reports;

Recommendation 12: ensuring that policies and procedures for purchasing are followed; and

Recommendation 13: ensuring staff is properly trained in processing payroll.

FIXED ASSETS

LAWV's Financial Manual details policies and protocols that are in accordance with LSC's *Fundamental Criteria* and the Property Acquisition and Management Manual (PAMM). However, some of the specified information required by Appendix II of the Accounting Guide is not included in LAWV's Financial Manual. Items missing from the Financial Manual for the fixed assets record include the date of acquisition, check number used to pay for items, source of funds and inventory control/tag number.

We found that LAWV's policies and procedures related to property and equipment need to be strengthened. A physical inventory is conducted every two years, yet LAWV needs to ensure the physical inventory is reconciled to the property records. In addition, some equipment purchased prior to the scope of our audit was not properly capitalized and included in the property records.

Inventory and Fixed Assets Records

Per LAWV's Financial Manual, the Administrative Director shall ensure that an inventory is taken of all physical assets and property of LAWV biannually. Management further explained any items purchased greater than $100 are tagged and included in the biannual inventory. While a physical inventory was conducted as required by the *Fundamental Criteria*, the results of the physical inventory count were not reconciled to the property record. During our testing we noted one of the four items selected could not be located within the LAWV office. Grantee management determined the property record was not updated after the disposal of the item.

The property record was examined to ensure it contained the required information prescribed in Appendix II of the Accounting Guide. The record did not contain four information fields required by the LSC Accounting Guide: 1) source of funds used to purchase assets, 2) model/serial numbers, 3) disposal dates, and 4) check number used to purchase the item.

According to the Accounting Guide, property records account for fixed assets and equipment and should include, at a minimum, the 11 items listed in Appendix II. Section 2-2.4 of the Accounting Guide states for property control purposes, a physical inventory should be taken and the results reconciled with the property records at least once every two years.

Capitalization of Fixed Assets

LAWV's Financial Manual requires that all physical assets with a value greater than $5,000 and a useful life of greater than one year are defined as a fixed asset. During our review of fixed assets and contracting, we noted a videoconferencing system was purchased in 2010 by LAWV which was not capitalized. We reviewed the purchase order for the system and found the total amount included in the purchase order was approximately $98,800.

Section 2-2.4 of the Accounting Guide requires grantees to capitalize and depreciate all nonexpendable items with a cost in excess of $5,000 and a useful life of more than one year. The purchase order included several items that were under the required $5,000 threshold; however, there were three items with a unit price greater than $5,000. Based on this information, we determined not all fixed assets were properly accounted for in LAWV's accounting system and financial statements.

LAWV management explained the system was purchased with a portion of LSC Technology Initiative Grant (TIG) funds and therefore, the purchase was recorded as an expense to properly match the expense to the revenue. A review of the TIG award package received from LSC management found there were no specific guidelines for the purchase of property. However, a review of the overall TIG compliance information states all TIG funds used to acquire, use and dispose of real and nonexpendable personal property must follow LSC regulations and the PAMM.

Recommendations: The Executive Director should:

Recommendation 14: ensure fixed assets policies and procedures in the financial manual fully capture applicable requirements included in the Accounting Guide as well as the PAMM;

Recommendation 15: update the property records to include all fields required by Appendix II of the Accounting Guide;

Recommendation 16: ensure the results of physical inventory counts are reconciled with property records;

Recommendation 17: ensure all fixed asset purchases are properly capitalized, and the videoconferencing system is added to the property records and the proper general ledger fixed asset accounts.

CLIENT TRUST FUND ACCOUNTING

Client trust funds written policies and procedures need to be expanded in accordance with LSC's Accounting Guide. We further determined that LAWV currently does not have processes in place to report unclaimed client trust funds and ensure deposit slips are completed and kept with client trust files.

We reviewed the LAWV Client Trust Account Policies and Protocols and Rules for Safeguarding Client Property. While many of the clients' trust receipts and disbursement policies were adequate and in line with LSC's *Fundamental Criteria*, some of the requirements elaborated in Appendix V of the Accounting Guide were not included in the policies and protocols to include:

- A reconciliation of client balances;
- Marking accounts closed;
- Moving files to inactive once closed;
- Periodically reporting to program attorneys client trust balances which have been inactive for more than six months; and
- Where a case is closed and the client cannot be located, programs should follow the state regulations for the disposal of funds.

We reviewed the 2013 and 2014 general ledgers received and selected two client trust accounts for testing. For the two client trust accounts selected, all receipts and disbursements were included in the client trust accounts cash journal and the client trust log maintained by the CFO. The cash receipts and disbursements are maintained on one log for each client, there is no separate receipt and disbursement log. For one of the client trust accounts, all the required supporting documentation for the cash receipts and disbursement was included. For the other, all the cash disbursement supporting documentation was included. However, for three of the five client trust account receipts a cash receipt was not included. According to LAWV CFO, the files were missing client receipts as a new attorney took over the case and was trying to learn the logistics of client trusts.

During our review of client trust accounts, we found 16 client trust accounts that are older than five years with a total balance of approximately $6000. Per discussion with LAWV management, the state of West Virginia does not have an escheat law for client trusts so LAWV contacted the West Virginia State Bar. The West Virginia State Bar explained that after keeping the funds for five years after the conclusion of the representation, the funds can be donated to the West Virginia State Bar IOLTA Fund. LAWV is proceeding to implement reporting of unclaimed funds.

Recommendations: The Executive Director should address the OIG recommendations by:

Recommendation 18: updating client trust policies to include all policies required per the Accounting Guide.

Recommendation 19: ensuring that client trust receipts are documented on a three-part cash receipt and distributed as required per the Accounting Guide.

Recommendation 20: researching the West Virginia unclaimed property law in regards to unclaimed money and ensure closed account balances are reported and closed as required.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed for the most part with the findings and recommendations contained in the report. Grantee management addressed some of the recommendations through changes in its Accounting Manual approved at the December 2014 Board meeting. Others will be addressed at the next quarterly Board meeting scheduled in February 2015.

In addition to the Accounting Manual update:

- LAWV will allocate maintenance contract cost line items in state grant budgets, beginning July 1, 2015.
- Management will maintain a contract listing in accordance with revised policy.
- Management will review LSC non-allowable costs with both new and existing accounting staff.
- Management will expand its employee travel policies to ensure all travel expenses are reported on an employee's electronic expense form. Two training sessions for LAWV staff are planned.
- The credit card cardholder agreement will be modified and all cardholders requested to sign the revised agreement.
- LAWV will update the property records to ensure all required fields are included. LAWV will also include any fixed asset purchases on the property records.
- Management will train local office personnel on client trust receipt procedures.
- Management hired a new payroll clerk and is currently completing the LAWV training process.
- LAWV Audit Committee and Board approved language in the Accounting Manual setting a spending limit on credit cards.

Management's formal comments can be found in Appendix II.

OIG EVALUATION OF GRANTEE COMMENTS

The OIG considers the proposed actions to address Recommendation 1 - 7, 9, 11, 12, 14, 18, 19 and 20 as responsive. Recommendations 1, 2, 3, 5, 6, 7, 14, 18 and 20 will remain open until your Board of Directors approves the revised Accounting Manual and the OIG receives written notification thereof. The other recommendations; 4, 9, 11, 12 and 19; will remain open until the OIG is notified in writing that the proposed action has been completed or implemented.

The OIG does not consider your comment to Recommendation 16 responsive and is referring it to LSC management for resolution. While we noted a physical inventory is performed by the grantee, we noticed the property records are not updated after the physical inventory. The grantee management's response for Recommendation 16 only states this is a current practice, the response does not include what procedures will be performed at this time to correct the specific issue.

Since the actions implemented have fully addressed Recommendations 8, 10, 13, 15, and 17, we consider them closed.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Payroll/Employee Benefits,
- Cash Disbursements,
- Contracting,
- Credit cards,
- Property and Equipment,
- Internal Management Reporting and Budgeting,
- Derivative income,
- Client trust funds and
- Cost Allocation.

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 grantee 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 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 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 consisted of 83 disbursement checks totaling $231,317.54. The sample represented approximately 7 percent of the $3,496,415.01 disbursed for expenses other than payroll during the period January 1, 2013 to May 31, 2014. 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 and test internal controls over the employee benefits, credit card use, contracting, property and equipment, internal management reporting and budgeting and client trust funds, we interviewed program personnel, examined related policies and procedures as applicable and selected specific transactions to review for adequacy.

To evaluate the adequacy of the cost allocation process, we discussed the cost allocation process for 2014 with grantee management and requested, for review, the grantee's written cost allocation policies and procedures as required by the LSC Accounting Guide. We performed detailed cost allocation testing of four transactions, reviewing for the reasonableness of the costs; to determine if the amounts allocated in conformity with the Cost Allocation Statement; and if the transactions were properly allocated in the accounting system.

Controls over derivative income were reviewed by examining current grantee practices in comparison with policies outlined in the LSC Accounting Guide. A sample of attorneys' fees hours recorded within LAWV's timekeeping system was compared with revenue recorded in the general ledger.

The on-site fieldwork was conducted from July 14 through July 23, 2014. Our work was conducted at the grantee's central administrative office in Charleston, WV 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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December 30, 2014

Mr. John M. Seeba
Assistant Inspector General for Audit
Office of the Inspector General
Legal Services Corporation
3333 K Street NW, 3rd Floor
Washington, DC 20007-3558
(via hard copy and e-mail: jseeba@oig.lsc.gov)

RE: Response to Draft Report on Selected Internal Controls – RNO 449041

Dear Mr. Seeba:

I am in receipt of the draft report of your audit of Selected Internal Controls at Legal Aid of West Virginia, conducted over a ten day period in July, 2014. I appreciate the efforts of the team of OIG staff who visited West Virginia, including the professional manner in which they conducted the audit.

I am providing you with our comments addressing the twenty recommendations in the draft report. We have reviewed all recommendations and are taking action in each area. Some recommendations were already addressed through changes in our Accounting Manual, approved at our Board meeting on December 12, 2014. The remainder will be addressed at our next quarterly Board meeting scheduled for February 6, 2015.

There are three areas of the report in which LAWV wanted to provide further clarification as it relates to issues raised in the OIG's report. These include:

1. **Page 8 Disbursements:**
   The OIG notes in its fourth bullet "One disbursement totaling $525 was noted as a personal transaction." The referenced transaction was NOT a personal transaction but the cost of sending three LAWV staff, three Kaufman Award (pro bono) winners and two of the award winners' spouses to the WV State Bar's annual banquet. The entire event and transaction was related to LAWV's pro

bono recognition work with the State Bar. The paperwork was given to the auditor but they noted it as "personal."

On the same page the report states "LAWV management stated the unallowable and unapproved disbursements might have been due to an oversight. In addition, the grantee stated the personal transaction was reimbursed but support for the reimbursement was not provided." Documentation for any "personal" transactions (e.g. payment for a spouse at LAWV's statewide banquet) was provided.

2. **Page 10 – Credit Cards**
   On page 10, in Recommendations 10-13, the Recommendations are introduced with the sentence "The Executive Director should address these payroll issues by..." Only one of the four recommendations is payroll-related so LAWV suggests the OIG may want to change the introductory language.

3. **Page 12 Client Trust Fund Accounting.**
   Lawyer trust account deposits are not governed by general escheat laws in West Virginia. The OIG team was provided an accurate description of the process applicable at the time of the visit for disposing of trust account funds that cannot be identified or returned to the client involved. That process was superseded by a new West Virginia State Bar Administrative Rule in September 2014. The Bar Administrative rules section involved is WVSB Administrative Rule §10.09 "Disposition of IOLTA Funds Whose Owners Cannot Be located Or Cannot Be Identified". This rule was made effective on September 29, 2014 by an Order of the West Virginia Supreme Court of Appeals. As noted below in LAWV's response to Recommendation 20, LAWV will update the LAWV Client Trust Account Procedures to reflect the new rules.

Each of the recommendations from the draft report on your Audit of Selected Internal Controls is addressed below.

Derivative Income:

Recommendation 1:
The Executive Director should formalize written policies and procedures for recording and allocating derivative income in accordance with the LSC Accounting Guide.

LAWV Response:
LAWV will revise our current methodology to meet the requirement of 45 CFR §1609.4 and add it to the Board-approved Accounting Manual by February 15, 2015.

Recommendation 2:
The Executive Director should develop written policies and procedures to ensure that the requirements of 45 CFR §1609.4 (a) related to the recording of income derived from attorney's fees is fully implemented.

LAWV Response:
LAWV's current practice is to use LSC's Accounting Guide procedures in recording derivative income. LAW will add written procedures to the Board approved Accounting Manual to allocate derivative income to appropriate grant(s) by February 15, 2015.

Cost Allocations:

Recommendation 3:
The Executive Director should ensure that the cost allocation addresses the methodology for allocating costs associated with a comprehensive range of contract types, describes the methodology for allocating indirect salaries and wages and refers to the distribution codes that LAWV uses to allocate expenses.

LAWV Response:
LAWV will modify current written policies and procedures in the Board-approved Accounting Manual by February 15, 2015 to address all costs

Recommendation 4:
The Executive Director should ensure that the annual cost of maintenance contracts is allocated across funding sources according to LAWV's office distribution codes.

LAWV Response:
LAWV will allocate maintenance contract cost line items in state grant budgets, beginning July 1, 2015.

Recommendation 5:
The Executive Director should ensure that at year-end the fund accounts used for interfund transfers, including the expense, revenue and accounts receivable, have zero balances in the accounting system.

LAWV Response:
LAWV will add a written procedure that formalizes current account reconciliation practices to our Board-approved Accounting Manual by February 15, 2015.

Contracting:

Recommendation 6:
The Executive Director should formalize written policies and procedures for contracting with recommendations in the report and the Fundamental Criteria.

LAWV Response:
Policies and procedures for contracting will be added to the Board-approved Accounting Manual by February 15, 2015.

Recommendation 7:
The Executive Director should ensure that the contracting practices adhere to LSC requirements including a) the documentation maintained is complete with the process used for each contract action; b) there is adequate support for competition or sole sourcing of the contract; and c) the documentation is maintained in a central file.

LAWV Response:
These requirements will be in the revisions to the Accounting Manual as noted above.

Recommendation 8:
The Executive Director should ensure the official listing of contracts maintained is complete and sufficiently detailed; the approved contracting process is fully documented, approved and maintained in the contract file, and the statement of work is sufficiently detailed.

LAWV Response:
The contract list will be maintained in accordance with the revised policy, beginning January 1, 2015 for all contracts.

Disbursements:

Recommendation 9:
The Executive Director should mandate that adequate supporting documentation is maintained for expenditures to ensure LSC funds are used only for authorized purposes.

LAWV Response:
It is LAWV's current practice to require adequate supporting documentation for all expenditures. LSC non-allowable costs will be reviewed with both new and existing accounting staff prior to January 15, 2015.

Credit Cards:

Recommendation 10:
The Executive Director should address these payroll issues by setting a spending limit on credit card purchases.

LAWV Response:
On December 12, 2014 the LAWV Audit Committee and Board approved language in the Accounting Manual setting a spending limit on each card. All current cards have individually assigned credit limits (which range between $2,000 - $5,000). The credit card policy language was modified to designate a spending limit which will be equal to the credit limit.

Recommendation 11:
The Executive Director should address these payroll issues by having employee travel related costs charged on credit cards included and reconciled with the employee expense reports.

LAWV Response:
LAWV will expand its employee travel policies to ensure that <u>all</u> travel expenses are reported on an employee's electronic expense form for a complete picture of that employee's travel. Two training sessions for LAWV staff are planned. One was held on December 10, 2014 and a second will be held on January 7, 2015, both as part of regularly scheduled staff e-form training.

Recommendation 12:
The Executive Director should address these payroll issues by ensuring that policies and procedures for purchasing are followed.

LAWV Response:
Credit card policies in Accounting Manual were revised at the December 6, 2014 Board meeting to include progressive discipline for violations. The cardholder agreement will be modified and all cardholders requested to sign in the revised agreement in January 2015. The LAWV Management Team was notified of revision to policies and procedures on December 5, 2014.

Recommendation 13:
The Executive Director should address these payroll issues by ensuring staff is properly trained in processing payroll.

LAWV Response:
The payroll clerk who had been hired just prior to the LSC visit was not retained because of training problems and a high error rate. A new payroll clerk has been hired and is currently completing the LAWV training process.

Fixed Assets:

Recommendation 14:
The Executive Director should ensure the fixed assets policies and procedures in the financial manual fully capture applicable requirements included in the <u>Accounting Guide</u> as well as PAMM.

LAWV Response:
LAWV will modify current written policies and procedures to the Board-approved Accounting Manual by February 15, 2015 to ensure the fixed assed policies capture all applicable requirements.

Recommendation 15:
The Executive Director should update the property records to include all fields required by Appendix II of the Accounting Guide.

LAWV Response:
Per the policy, beginning in 2015, all required fields will be included in the property records.

Recommendation 16:
The Executive Director should ensure that the results of the physical inventory counts are reconciled with the property records.

LAWV Response:
This is a current practice, which will continue.

Recommendation 17:
The Executive Director should ensure all fixed asset purchases are properly capitalized and the videoconferencing system is added to the property records and the proper general ledger fixed asset accounts.

LAWV Response:
LAWV will continue to record all fixed asset purchases as such and include any fixed asset purchases on the property records. LAWV's video conferencing system will be added to the property records and to the fixed assets by December 31, 2014.

Client Trust Fund Accounting:

Recommendation 18:
The Executive Director should address the OIG recommendations by updating the client trust policies to include all policies required per the Accounting Guide.

LAWV Response:
LAWV will modify existing written policies and procedures to the Board-approved Accounting Manual by February 15, 2015 to address additional requirements.

Recommendation 19:
The Executive Director should address the OIG recommendations ensuring that client trust receipts are documented on a three part cash receipt and distributed as required per the Accounting Guide.

LAWV Response:
The Administrative Office will confirm by February 15, 2015 that all offices have the appropriate three part cash receipt, which is a part of LAWV's current client trust procedure. Local office personnel will be retrained on client trust receipt procedures by February 15, 2015.

Recommendation 20:
The Executive Director should address the OIG recommendations by researching the WV unclaimed property law in regards to unclaimed money and ensure closed account balances are reported and closed as required.

LAWV Response:
LAWV will modify existing written policies and procedures to the Board-approved Accounting Manual by February 15, 2015 to address the new WVSB Administrative Rule §10.09 and closed account balances.

We appreciate the opportunity to improve our internal controls, grant compliance and fiscal accountability. Please let me know if you have any questions or require additional information. Thank you!

Sincerely,

Adrienne Worthy

Adrienne Worthy
Executive Director