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Legal Services Corporation

Inspector General
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October 9, 2014

Mr. Raun Rasmussen
Executive Director
Legal Service NYC
40 Worth Street, Suite 606
New York, NY 10013

Dear Mr. Rasmussen:

Enclosed is the Office of Inspector General's (OIG) final report for our audit of Selected Internal Controls at Legal Services NYC. 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 your actions taken and planned actions responsive to all of our recommendations. However Recommendations 5, 6, 7, 8, 9 and 11 are still considered open until the OIG is notified in writing that the planned actions have been completed and implemented. Recommendations 1, 2, 3, 4 and 10 are considered closed.

The OIG is referring $196,387 in questioned costs to LSC Management for their determination. These costs involve attorney fees received by Legal Services NYC that were not allocated to LSC.

We thank you and your staff for your cooperation and assistance.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President
Lynn Jennings, Vice President for Grants Management

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

LEGAL SERVICES NYC

RNO 233100

Report No. AU 15-01

October 2014

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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 Services NYC (LSNYC or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in New York, NY; three branch offices located in the Bronx, Staten Island and Manhattan; 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

LSNYC is a New York based not-for-profit corporation organized for the purpose of providing legal assistance in noncriminal legal proceedings or matters to indigent persons in the New York City area. LSNYC is authorized to practice law under Section 495 of the New York Judiciary Law and employs licensed attorneys to provide legal services to eligible clients. LSNYC received significant funds from the federal LSC as well as a variety of other sources. LSNYC disburses grant funds received from the LSC and other funders to its Constituent Corporations (CCs) and oversees fiscal and compliance responsibilities with respect to all of these entities. LSNYC maintains the books of account for the CCs (all of which are separate corporations) and makes payments for substantially all of their expenditures. LSNYC is comprised of administrative and program units which include:

Central Administration
Brooklyn Branch

Brooklyn Family and Defense Project[1]
Staten Island Branch
Legal Support Unit

LSNYC's six CCs[2] include:

Bedford-Stuyvesant Community Legal Services Corporation
Brooklyn Legal Services Corporation A[3]
Queens Legal Services Corporation
South Brooklyn Legal Services Corporation
Manhattan Legal Services
Legal Services NYC - Bronx

As part of our audit, the OIG visited offices located in the Bronx, Staten Island and Manhattan CCs and reviewed specific accounting functions in those offices.

According to the audited financial statements for the grantee's year ended December 31, 2013, approximately 58 percent of the grantee's total support funding was provided by three funding sources: LSC, the State of New York and New York City. LSNYC received $13,085,729 from LSC, $8,819,078 from the State of New York and $5,413,407 from the city. In addition, the grantee received $6,178,558 from the federal government (other than LSC) and $13,577,623 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 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.

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[1] LSNYC transferred the ownership and operation of the Brooklyn Family Defense Project to Brooklyn Defender Services ("BDS"), an unrelated New York not-for-profit corporation, pursuant to an agreement, dated and effective December 1, 2012 between LSNYC and BDS.

[2] Under LSNYC's governance structure, services are provided by a system of constituent corporations and branch offices. The constituent corporations (CCs) are linked to LSNYC through a membership corporation structure under New York's Not-for-Profit Law. LSNYC, through its Board of Directors, is the controlling member of the CCs and has powers that include the power to appoint and remove members of CC Board of Directions, to approve appointment of or remove a Project Director, and to oversee finances and quality of services. The CCs remain responsible for the delivery of services in their communities.

[3] In August 2012, Brooklyn Legal Services Corporation A ("Brooklyn A") decided to disassociate from LSNYC. The disassociation occurred February 15, 2013, pursuant to the by-laws of Brooklyn A.

AUDIT FINDINGS

DERIVATIVE INCOME

Attorneys' Fees

LSNYC did not allocate any of its attorneys' fees income to LSC in FY 2013 according to OIG's review of the general ledger, financial statements and discussions with the Controller. According to the December 31, 2013 audited financial statements, the grantee received $329,939 in attorney fees in 2013, all of which was recorded in an unrestricted revenue account. The OIG reviewed a sample of six of the 25 cases involving attorneys' fees that were included in the general ledger. The revenue for the six cases totaled $208,620. For five of the six cases, LSNYC's internal case management 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 94 percent of the hours were charged to LSC. As a result, based on the six cases in our sample, $196,387 should have been allocated to LSC.

LSNYC has written policies and procedures in the accounting manual for recording and allocating attorneys' fees that do not appear to accurately capture the requirements contained in LSC's Accounting Guide and 45 CFR §1609.4 (a). According to the accounting manual, LSNYC may receive attorneys' fees for damages awarded and/or statutory benefits. Attorneys' fee revenue is recorded in a general ledger revenue account during the accounting period in which the fees are actually received. The accounting manual further provides that such fees are allocated proportionately to the fund and account assigned to the LSC grant. Attorneys' fees received by LSNYC for representation supported in whole or in part by various funders are allocated to each funder in accordance with fund requirements.

Nevertheless, the grantee's written policy on attorneys' fees does not provide that these fees must be allocated to the LSC fund in the same proportion that the amount of LSC funds expended bears to the total amount expended by the grantee to support the representation.

Also, the grantee appeared to have no established practices in place to allocate the attorneys' fees. All attorneys' fees were allocated to an unrestricted account.

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. According to LSNYC's Controller, attorneys' fees were not allocated because they were not using the case management system to its full capability. She stated that the current case management system provides more clarity and transparency in how the attorneys are charging their time. However, grantee management still did not allocate to LSC any of this recorded revenue.

Since attorneys' fees tested and documented in our sample were not allocated to LSC in accordance with the meaning of 45 CFR §1609.4, the OIG is questioning $196,387 of those attorneys' fees. The OIG will refer the questioned costs to LSC management for review and action.

Interest Income

LSNYC received $15,491 of interest income according to the grantee's December 31, 2013 audited financial statements. All of the income was recorded to an unrestricted revenue account and none was allocated to LSC. The grantee has no written methodology for allocating interest income in the accounting manual and no practices are in place. The audited financial statements showed that LSC revenue accounts for approximately 28 percent of LSNYC's total revenue, so roughly $4,337 of the interest income could have been allocated to LSC if based on percentage of revenues received.

The LSC Accounting Guide provides that LSC considers derivative income as any additional income derived from an LSC grant, such as interest income, rent or the like, or that portion of any reimbursement or recovery of direct payments to attorneys, proceeds from the sale of assets, or other compensation or income attributable to any LSC grant. LSC derivative income must be reported in the same class of net assets that includes the LSC grant.

According to LSNYC management, there is not much interest income; therefore they do not split it among the grants. Properly recording any interest income ensures that LSC is apportioned its fair share of income to be used to provide legal services to LSC eligible clients.

Written Policies

Our review of the accounting manual revealed that policies and procedures for derivative income were not documented. The grantee received derivative income in the form of rent, interest, gains (losses) on disposal of property and attorneys' fees. The grantee has adequate documented policies and procedures for recording gains (losses) on disposal of property; however, the grantee does not have documented policies and procedures or practices in place for recording and allocating rental and interest income to the various funding sources. According to LSNYC management, they were unsure of what was actually considered derivative income, and consequently did not prepare an overall written policy in this area.

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. 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.

Recommendations: The Executive Director should:

Recommendation 1: ensure that all derivative income is properly accounted for and allocated to the related funding sources.

Recommendation 2: update and revise the written policies and procedures for attorneys' fees to mirror LSC requirements.

Recommendation 3: formalize written policies for all derivative income including rental and interest income. The policies should establish a methodology so that such income is properly accounted for and allocated to the related funding sources.

DISBURSEMENTS

Unallowable Costs

The OIG found 12 transactions totaling $2,397.50 paid to the New York City Bar Association for unallowable membership dues. 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. These dues were not mandated by a governmental organization so that the attorneys could engage in their profession. Six of the transactions were paid with LSC funds totaling $1,320 and the remaining $1,077.50 were paid with other donor funds. The grantee does not have a policy in the accounting manual on the payment of membership dues outlining LSC restrictions. Management explained there was a lack of understanding of LSC regulations that prohibits grantees from allocating the cost of membership dues paid to bar associations. The determination that costs are allowable helps to ensure that grantees use funds only for authorized purposes.

Purchase Orders/Requisitions

From the sample of 147 disbursement checks reviewed, we noted nine checks, totaling $27,994.36, for which LSNYC created the purchase order and/or the purchase requisition after receipt of an invoice. The total amount charged to LSC for these checks was $6,337.36.

For four of the checks, totaling $12,807, both the dates of the purchase requisition and purchase order were after the date of the invoice, indicating that LSNYC made the purchase before getting documented prior approval of that purchase. This practice did not adhere to the purchasing policies outlined in the accounting manual, which states that all purchase requisitions must be approved by designated individuals and purchase orders must be approved by authorized individuals before a purchase can be made. None of these checks were charged to LSC.

For the remaining five checks, the related purchase orders were also prepared after LSNYC received the vendor invoice. The total of these checks was $15,187.36, of which $6,337.36 was charged to LSC.

Section 3-5.4, Cash Disbursement, Managing Purchases, of the Accounting Guide states that approvals should be required at an appropriate level of management before a commitment of resources is made. It also states that criteria for purchases should be documented along with appropriate procedures. Section 5030 of the accounting manual states that all purchase requisitions must be approved by designated individuals and that all purchase orders must be approved by authorized individuals before a purchase can be made.

LSNYC staff explained purchase orders may be created after receipt of an invoice because LSNYC maintains a central accounting department while purchasing often takes place in field offices. The field offices do not always make a purchase requisition or purchase order prior to securing goods and services. As such, in order to properly document the purchase, purchase orders are completed after the fact.

Adhering to a purchase order system helps ensure that disbursements are appropriately approved prior to purchases being made adequately supported, and that grantee funds are used only for their intended purpose.

Master Vendor List

Controls over master vendor list maintenance are lacking and need to be strengthened. Employees with accounts payable duties, which include initiating and processing payments, have primary responsibility for creating new vendors and the ability to edit vendor information in the accounting information system. Those employees with access can create and change vendor information without prior approval from management at the central office. This could result in unauthorized vendors being set up to receive payments or address changes resulting in payments sent to incorrect locations.

Approving vendors appropriately and controlling access to the vendor master list helps to ensure that only authorized and approved vendors are paid.

Additionally, LSNYC does not have written polices or a formalized process in place for establishing, vetting and approving new vendors. New vendors are created in the system normally by the Accounting Associate/Purchasing Agent or the Accounts Payable Specialist upon receipt of a Purchase Requisition, Purchase Order or Check Request from a field office. The Controller stated that management at field offices, where most purchases are initiated, is authorized to establish and approve relationships with new vendors. The Central Office, where payments are processed, is normally not involved in the approval process for establishing new vendors. The Central Office relies on the determination of the field offices regarding whether potential new vendors are legitimate and reputable. Prior to setting up new vendors in the accounting system or generating payment, the Central Office does not require that the field offices provide documentation substantiating the approval process for new vendors. Establishing a formal vendor approval process, including securing business references and management approval of new vendors, would help ensure that LSNYC engages in business with legitimate and reputable entities.

Section 3-4, Internal Control Structure, Segregation of Duties, of the Accounting Guide states accounting duties should be segregated to ensure that no individual simultaneously has both the physical control and the record keeping responsibility for any asset, including, but not limited to, cash, client deposits, supplies and property. Duties must be segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

Recommendations: The Executive Director should:

Recommendation 4: abide by LSC regulations and ensure that LSNYC does not use LSC funds to pay for unallowable membership dues.

Recommendation 5: adhere to the grantee's established policies for purchasing and accounts payable and ensure that purchase requisitions and purchase orders are received, reviewed and approved prior to the purchase of goods and services. This should include ensuring that the field offices follow the grantee's established policy.

Recommendation 6: establish written policies for securing and approving new vendors. These policies should outline procedures for setting up new vendors in the accounting information system to ensure that only employees independent of the accounts payable function are allowed to create new vendors and edit vendor information.

CONTRACTS

The grantee's written contracting policies and procedures are in conformity with the *Fundamental Criteria*. However, LSNYC could not provide evidence of competitive bidding or documentation substantiating single source contracting for two of the five contracts in our test sample. The first contract was to provide clinical supervision of social workers employed by LSNYC with a maximum contract value of $45,000. The second contract was to provide technical consulting services in the amount of $13,000.

Based on our sample, the grantee's current practices involving soliciting and awarding contracts were not always in accordance with their contracting policy or LSC's *Fundamental Criteria*. According to LSNYC management and LSNYC contracting policies and procedures, both contracts should have been competitively bid. For both of the contracts, the purchasing agent was on vacation at the time the purchase orders were created and the staff that filled in did not require evidence of competitive bidding before processing the purchase order. Management stated that the vendors both have a long-standing relationship with LSNYC. The grantee also did not prepare a written sole source justification substantiating the single source purchase as required in LSNYC contracting policy.

The accounting manual states the Controller and Accounting Associate should review all requests for payment submitted by the organization. Where a good or service is unique, highly specialized, available from only one vendor or a vendor is uniquely qualified to provide a good or service; fewer than three quotations are acceptable provided that the selection is accompanied by a written justification for the conclusion that the good or service meets one or more such criteria and has been approved by persons consistent with the threshold guidelines.

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 that contract deliverables can be identified and monitored to ensure that the deliverables are completed. The type and dollar value of contracts that require competition should be included in the policies of the grantee. Documents to support competition should be retained and kept with contract files.

We also found that LSNYC did not adhere to its contracting policies outlined in the accounting manual with respect to obtaining business references and conflict of interest disclosures for consultants. For three of the five contracts tested, LSC OIG found that LSNYC did not obtain the two business references required for each consultant contract. LSNYC also did not require the contractors to complete a Conflict of Interest disclosure. Two were technical consulting contracts for $62,000 and $13,000; the other was supervision of social workers employed by LSNYC for $45,000.

According to LSNYC management and staff, these two policies are not ones by which LSNYC routinely abides. The accounting manual was revised in December 2013 and these policies were likely rolled over from the previous version even though they do not reflect LSNYC's current practices. Prior to recent revision, the accounting manual had not been updated for more than nine years.

By not subjecting these contracts to competitive bidding and documenting the justification, it's not clear whether the grantee received the best price and service available for the money spent.

Recommendations: The Executive Director should:

> Recommendation 7: ensure that the grantee adheres to its written policies and procedures for contracting, and removes any obsolete policies no longer followed.
>
> Recommendation 8: ensure that employees in the finance department are adequately cross-trained to handle the job duties and responsibilities of the different positions within that department.

COST ALLOCATIONS METHODOLOGY

LSNYC receives over 400 different grants and contracts annually. Grants are generally in the form of city-wide grants or local grants. Journal entries are used to move costs between grants when necessary. The OIG interviewed staff to obtain an understanding of the cost allocation process and performed test work based on the practices described during these interviews. According to LSNYC's cost allocation policy, all program costs are deemed direct costs. Central Administrative Office (CA) and a portion of Legal Support Unit (support and development of legal staff) expenses are deemed indirect costs that are distributed over all programs. LSNYC has an approved indirect cost rate of 11.2 percent of total costs, if allowed by the specific grant. The 11.2 percent is taken from each grant and allocated to the CA as indirect cost revenue.

We randomly selected 11 grants and contracts to determine that the indirect costs were correctly allocated as CA office revenue. We found various methods are being used by the grant accountants to record indirect cost/CA office revenue. The grantee was not using a consistent methodology in recording the indirect costs/CA office revenues. For the most part, the amounts were being allocated in accordance with the established percentage, however, there were some minor variances noted in our recalculations. We discussed the variances with LSNYC staff and they explained that these variances would be corrected through journal entries at the conclusion of the grant or contract year. As part of our audit, we tested journal entries made throughout the year and at year end. We reviewed support for the entries, their purpose and whether there was proper approval. We found no problems and the entries appeared reasonable.

All city grant revenue and contract revenue are distributed across the programs (locations) based on the census poverty population data. Local grant revenues are recorded to the program specified in the grant.

We reviewed a sample of 5 of the approximately 1990 journal entries prepared by the grantee during the year and at year-end, and all seemed properly prepared, with a specific justified purpose and adequately supported. Generally, the purpose of these entries was to move funds between grants, record indirect cost revenue and as a result of auditor year-end adjustments.

We also tested 5 grants/contracts that were not charged indirect costs. We found that those grants/contracts did not allow indirect costs to be charged.

Based on our test work performed, LSNYC's methodologies for allocating costs were in accordance with the Accounting Guide; however the practices were not fully documented in the accounting manual.

Written Policies and Procedures

The grantee has a written cost allocation policy in the accounting manual; however, that policy does not fully and adequately describe the methodology used in practice. Based on our review and testing of the process, some of the practices in place that were not detailed in the accounting manual include:

- the disclosure that the Department of Justice approves an indirect cost rate proposal;
- the use of the census poverty population to distribute city-wide grants and contracts;
- a requirement on how grant accountants track awards, how they monitor those award expenses and how they must obtain an understanding of the budget and allowable expenses;
- the accounting for fundraising revenue and expenses;
- the various different methods used by the grant accountants to record indirect costs; and
- the purpose, processing and approval of reclassification entries used to move expenditures between grants.

As part of an internal control structure, each grantee must develop a written accounting manual that describes the specific procedures to be followed by the grantee in complying with the *Fundamental Criteria* contained in the LSC Accounting Guide, which require that financial controls be established to safeguard program resources. The Accounting Guide also 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.

City Wide Grant Revenue Distribution

LSNYC management used the wrong census data (2010 census) to allocate city wide grant revenue to its different programs. During our audit, we attempted to recalculate the Census poverty population distributions used to distribute all city-wide grants and contracts across the LSNYC programs (Manhattan, Bronx, etc.). Although we believe that its process is reasonable, we found that the allocation percentages being used by the grantee were incorrect. When we inquired further, we found that the grantee was using 2010 census data instead of 2011.

LSNYC management explained that all city grants and contract revenues are distributed across the programs based on the Census poverty population. In 2013, LSNYC was supposed to calculate the distributions based on the new 2011 Census information. The poverty populations numbers are used to ensure funding across the various programs are reasonable. Since LSNYC management determined that using current Census population data was an equitable way to distribute city-wide grant revenue, by not using the proper Census poverty populations, city grants and contract revenue would not be distributed in accordance with management's intentions.

The Director of Grant Accounting informed us that because the wrong census distribution percentages were being used during the year (2013), an entry would have to be prepared at year-end to correct the program distributions. We reviewed the LSC revenue entry and determined that the program distributions were adjusted and based on the correct census data.

Recommendations: The Executive Director should:

Recommendation 9: ensure that all cost allocation processes as practiced by the grantee are fully documented in writing in the accounting manual.

Recommendation 10: ensure that both a process and controls are in place for accounting staff to obtain and use the correct census information during the year so that city wide revenue is being properly allocated to the various programs.

MANAGEMENT POLICIES

The grantee did not have a written employee Code of Conduct or a Whistleblower Policy in place for the period under review. Grantee management explained that the staff is very comfortable with going to executive management to discuss and report problems. In addition, the grantee stated that they were close to completing a draft version of the employee Whistleblower Policy. As explained by the grantee, this had come about as a result of recent state legislation in New York requiring not-for-profits to have a Whistleblower Policy in place.

Organizations should produce a clear statement of management philosophy to include standards that are consistent with management's ethics policy. Organizations should establish and communicate a whistleblower protection policy to allow employees to come forward and report misconduct in the workplace. This policy should allow employees to confidentially report or seek guidance regarding actual or potential criminal conduct by others within the organization without fear of retaliation.

Without an employee Code of Conduct or Whistleblowers Policy in place (with annual staff refreshers) not all employees may be aware of such practices or feel sufficiently comfortable that an ethical environment exists encouraging and/or requiring such behavior.

<u>Recommendation 11</u>: The Executive Director, together with the Board of Directors, should formally adopt a Code of Conduct or ethics policy, along with a Whistleblower Policy. Both these policies should include initial training and annual staff refreshers. The written Code of Conduct should be given to every employee who shall be required to read and sign it.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

LSNYC management agreed with all of the findings identified in the draft report and also agreed with all 11 recommendations. The findings and recommendations included derivative income, disbursements, contracts, cost allocation and management policies. The grantee stated that they have created policies and procedures for recording and reporting derivative income. They stated that derivative income will be reviewed and recorded semiannually and fully reported based on supporting case data retrieved from their case management system. Also, accounting staff have now been trained to identify, record and report derivative income in accordance with LSC requirements. The grantee will provide continuous training and monitoring to the finance department to ensure compliance with LSC requirements.

With respect to disbursements, grantee management stated that periodic reviews of the general ledger will be performed by the Controller to find unallowable costs, including membership dues. The finance staff has been instructed and trained to be more proactive in finding unallowable costs such as membership dues and they will be provided with continuous communication and training to ensure compliance with LSC regulations. All relevant staff will also be provided training on the Purchase Order/Requisition process, focusing on communication and clarification of the steps required in this process. Finally, grantee management will establish written policies and procedures for securing and approving new vendors by the end of 2014.

To address the recommendations related to contracting, grantee management stated that they will create a checklist to be used by the end of 2014 to ensure contracts are supported by evidence of competitive bidding or documentation substantiating a single source status. Obsolete policies and procedures will be removed from the accounting manual and staff responsibilities in the finance department will be reviewed to ensure there is adequate cross training in place.

The key elements of the cost allocation methodology, as approved by the grantee's cognizant agency, will be added to their accounting manual in 2014. Communication between the Budget Director and Grant Accounting personnel will be enhanced to ensure census information is current and complete. Continuous communication and training will be provided to the finance department to ensure compliance with LSC regulations.

LSNYC adopted a whistleblowers policy and a conflicts of interest policy in June of 2014. A formal code of conduct or ethics policy will be adopted, reviewed and approved by the grantee's board of directors in 2015.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The grantee agreed with all of the findings and recommendations in the draft report. They have either initiated or are planning to take corrective actions in response to the OIG's draft report.

The grantee's actions taken and planned were responsive to Recommendations 1, 2 and 3 with respect to derivative income and the OIG considers these recommendations closed. However, the OIG will still question $196,387 in attorney fees as stated in the draft report and refer the questioned costs to LSC management for review and action.

The OIG considers the grantee's action taken and planned actions responsive to Recommendations 4, 5 and 6. As such, Recommendation 4 is considered closed. However, Recommendations 5 and 6 will remain open until the grantee notifies the OIG in writing that training on the Purchase Order/Requisition process has been completed and that written policies on securing and approving new vendors have been completed and included in the accounting manual.

With respect to contracting the grantee's planned actions are fully responsive to Recommendations 7 and 8. However, those recommendations are considered open until the OIG receives written notification that the contracting checklist has been created, the obsolete policies and procedures have been removed from the accounting manual and a review of staff responsibilities for possible cross training has occurred and any adjustments have taken place.

The grantee's actions taken and planned based on Recommendations 9 and 10 related to cost allocation are fully responsive. However, the OIG considers recommendation 9 open until the OIG is notified in writing that the key elements of the cost allocation methodology have been approved by the grantee's board of directors and included in the accounting manual. Recommendation 10 is considered closed.

The action taken and planned action by the grantee are fully responsive to the OIG's Recommendation 11. However, the recommendation will remain open until the code of conduct or ethics policy has been adopted and approved by the grantee's board of directors in 2015 and the OIG has been notified in writing.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Salary Advances,
- 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 and 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 147 disbursements totaling $383,847.95. The sample represented approximately 2.9 percent of the $13,445,108.59 disbursed for expenses other than payroll during the period January 1, 2013 to December 19, 2013.

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 salary advances, contracting, property and equipment, internal management reporting and budgeting and client trust funds; we interviewed appropriate program personnel, examined related policies and procedures and selected specific transactions to review for adequacy.

To evaluate the adequacy of the cost allocation process, we discussed the cost allocation process for 2013 with grantee management and requested for review the grantee's written cost allocation policies and procedures as required by the LSC Accounting Guide. We tested the cost allocation amounts and reviewed the related reclassification entries for 2013 using the information provided by the grantee.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the grantee's Accounting Manual. To evaluate controls over client trust fund accounting, we interviewed appropriate program personnel, examined related policies and procedures and performed recalculations of some revenue accounts.

The initial on-site fieldwork was conducted from January 13 through 17, 2014. Due to weather and scheduling considerations, the OIG could not return until June 2 through 6, 2014 to complete the audit. Our work was conducted at the grantee's central administrative office in New York, NY; three branch offices located in the Bronx, Staten Island, and Manhattan and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2013 through December 31, 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.

APPENDIX II

Legal Services NYC

September 29, 2014

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

Dear Mr. Ramirez:

Thank you for the opportunity to review the draft report on the results of your audit on Selected Internal Controls at our organization. Our comments are attached.

If you have any questions or need additional information, please contact me at 646-442-3589 or Betty Caines, Controller at 646-442-3632. Again, thank you for bringing the identified matters to our attention.

Regards,

Genia A. Wright

Genia Wright
Chief Operating Officer

Enclosure

Recommendations 1, 2 and 3 – The Executive Director should ensure that all derivative income is properly accounted for and allocated to the related funding sources.

Update and revise the written policies and procedures for attorney's fees to mirror LSC requirements.

Formalize written policies for all derivative income including rental and interest income. The Policies should establish a methodology so that such income is properly accounted for and allocated to the related funding sources.

Grantee Management Comment

- Legal Services NYC has created policies and procedures related to the recording and reporting of derivative income, and included those policies and procedures in the Accounting Manual.

- Derivative income will be reviewed and recorded semiannually and fully reported based on supporting case data as retrieved from our case management system, Legal Server.

- Appropriate accounting staff have been trained on the correct procedures to identify, record and report derivative income in accordance with LSC requirements.

- Continuous training and monitoring will be provided to the finance department to ensure compliance with LSC requirements.

Recommendations 4, 5 and 6 – The Executive Director should abide by LSC regulations and ensure that LSNYC does not use LSC funds to pay for unallowable membership dues

Adhere to the grantee's established policies for purchasing and accounts payable and ensure that purchase requisitions and purchase orders are received, reviewed and approved prior to the purchase of goods and services. This should include ensuring that the field offices follow the grantee's established policy.

Establish written policies for securing and approving new vendors. These policies should outline procedures for setting up new vendors in the accounting information system to ensure that only employees independent of the accounts payable function are allowed to create new vendors and edit vendor information.

Grantee Management Comment

- Periodic review of the general ledger performed by the Controller will include a more extensive review as related to unallowable costs, including membership dues.

- Finance staff have been instructed and trained to provide a more proactive review for unallowable costs such as membership dues. Continuous communication and training will provided to the Finance Department to ensure compliance with LSC regulations

- Before the end of 2014, LSNYC will provide training on the Purchase Order/Requisition process to all relevant staff. Training will focus on communication and clarification of the sequence of steps as required in this area to ensure the organization is in compliance with its policies related to purchasing and accounts payable.

- LSNYC will establish written policies and procedures for securing and approving new vendors by year end 2014. Accounting manual will be updated to include all enhanced procedures and training will be provided for all relevant staff.

Recommendations 7and 8 – The Executive Director should ensure that the grantee adheres to its written policies and procedures for contracting and removes any obsolete policies no longer followed.

Ensure that employees in the finance department are adequately cross-trained to handle the job duties and responsibilities of the different positions within the department.

- To ensure contracts are supported by evidence of competitive bidding and /or documentation substantiating a single source status, a checklist will be created and in-use by the end of 2014. The checklist will be included in the accounting manual and require the signature of the Controller and Accounting Associate documenting all steps and sign off as steps are completed.

- Obsolete policies and procedures will be removed from the Accounting Manual by the end of 2014.

- During 2014, staff responsibilities in the Finance department will be reviewed to ensure adequate cross-training is in place. Any required adjustments and training will take place in 2015.

Recommendations 9 and 10 – The Executive Director should ensure that all cost allocation processes as practiced by the grantee are fully documented in writing in the accounting manual.

Ensure that both a process and controls are in place for accounting staff to obtain and use the correct census information during the year so that city wide revenue is being properly allocated to the various programs.

- Key elements of LSNYC's cost allocation methodology as submitted and approved by our cognizant agency will be added into our accounting manual in 2014.

- Ongoing communication between the Budget Director and Grant Accounting will be enhanced to ensure census information as followed is current and complete.

- Continuous communication and training will provided to the finance department to ensure compliance with LSC regulations.

Recommendation 11 – The Executive Director should formally adopt a Code of Conduct or ethics policy.

- LSNYC adopted Whistleblower and Conflicts of Interest Policies in June of 2014.

- A Formal Code of Conduct or ethics policy will be adopted, reviewed, and approved by the board in 2015.