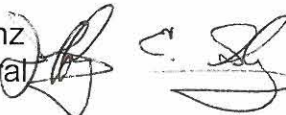




Inspector General
Jeffrey E. Schanz

MEMORANDUM

TO: Helaine Barnett
President

FROM: Jeffrey E. Schanz
Inspector General 

SUBJECT: Audit of LSC's Consultant Contracts

DATE: July 7, 2009

Attached is the Office of Inspector General's final report on the audit of LSC's consultant contracts. Your comments on the draft of this report are included in Appendix III.

The report makes 13 recommendations for improving internal controls over LSC consultant contracting practices. Your response to the draft report described actions on all recommendations. The OIG was not able to fully evaluate all management actions pending receipt of information, such as the opinion of outside counsel, and details regarding planned management actions. The OIG considers all recommendations open pending receipt and evaluation of additional information and management actions, with the exception of Recommendation 10, which the OIG considers closed because appropriate management actions were completed.

Please provide this office a copy of the revised Administrative Manual and the opinion of outside counsel regarding the classification of individuals as independent contractors versus employees. Also, please provide us with evidence of actions taken on each recommendation.

If you have any questions or need additional information, please contact me on extension 1677. Thank you and your staff for the cooperation and courtesy extended to the OIG auditors.

Attachment

cc: Victor Fortuno
Vice President for Legal Affairs/General Counsel/Corporate Secretary

Charles Jeffress
Chief Administrative Officer

Karen Sarjeant
Vice President for Programs and Compliance

**LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL**

**AUDIT OF
LEGAL SERVICES CORPORATION'S
CONSULTANT CONTRACTS**

Report No. AU09-05

July 2009
www.oig.lsc.gov

EXECUTIVE SUMMARY

Audit Process: The Legal Services Corporation (LSC) Office of Inspector General (OIG) determined whether appropriate internal controls over consultant contracts were in place and properly followed, and determined whether consultant contracting actions were in compliance with applicable laws, regulations, and LSC policies and procedures. Audit fieldwork was conducted from January through April 2009.

Results in Brief: Controls over consultant contracts were generally adequately designed; however, application of the controls was not enforced. LSC's written policies and procedures over the consultant contracting process were not regularly followed, resulting in instances of noncompliance.

LSC needs to strengthen internal controls over consultant contract actions by documenting contracting decisions, evaluating contract alternatives, and establishing procedures to monitor contractor compliance with contract provisions.

LSC may have entered into independent contractor agreements with individuals who should have been classified as employees under IRS rules. As a result, LSC could be liable for fines, penalties, and additional payments to workers.

LSC did not comply with its policies and procedures over the consultant contracting process. Specifically, competition requirements were not followed, required approvals were not obtained, required basic information was not used in some contracts, forms to control the contracting process were not used, purchase orders were not always prepared, and contracting records were not properly maintained.

Recommendations: The OIG made 12 recommendations to strengthen controls and ensure compliance with LSC policies and procedures. The OIG also recommended that management expeditiously resolve the issue of the status of LSC consultants as independent contractors versus temporary employees because of the potential financial risk that misclassification poses for LSC.

Management's Response: Management comments indicated that management will take action on all recommendations. Management also noted in its comments that the report did not question any costs. The full text of management comments can be found at Appendix III.

OIG Evaluation of Management's Response: The OIG was not able to fully evaluate all management actions pending receipt of information, such as the opinion of outside counsel, and details regarding planned management actions. The OIG considers all recommendations open pending receipt and evaluation of additional information and management actions, with the exception of Recommendation 10, which the OIG considers closed because appropriate management actions were completed.

While management's comment that the report questions no costs is accurate, the relevant cost issue is not what was spent in the past, but what must be spent in the future to correct any misclassifications. LSC could be liable for fines, penalties, and additional payments to workers. These costs could be significant.

The OIG's evaluation of management comments for each recommendation can be found in the report following the recommendations and associated management comments section. The OIG's overall evaluation of management comments can be found at page 23 of the report.

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BACKGROUND

Legal Services Corporation (LSC) contracting policies and procedures are contained in Chapter 1 of LSC's Administrative Manual. This chapter was last revised in February 2005. It is organized as follows:

- Part I – Definitions and Policies
- Part II – Procedures for Procurement of Goods
- Part III – Procedures for Contracting for Services
- Sample LSC Contract Approval Form
- Contract Originator's Contracting Procedure Outline

Most of LSC's consultant contracts are executed by the Office of Compliance and Enforcement (OCE) and the Office of Program Performance (OPP). OCE contracts with individuals to assist OCE staff in conducting visits in which grantees' records and activities are reviewed to ensure compliance with various LSC requirements. OPP contracts with individuals to assist OPP staff in conducting visits in which grantees' records and activities are assessed against LSC Performance Criteria. OPP also contracts with individuals as part of the grant competition process and in connection with the Technology Initiative Grant (TIG) Program to review grant applications and provide technical support. For the 2-year period of our review, LSC made payments on approximately 350 consultant contracts valued at approximately \$1.7 million.

Prior Audits

A January 6, 2009 Independent Public Accountant (IPA) audit of LSC's 2008 financial statements contained a finding dealing with classifying certain workers as independent contractors and recommended that LSC

...engage outside legal counsel to review this matter and consider obtaining a legal opinion or explore other options, such as submitting form SS-8 *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding* to the IRS, to ensure that LSC is fully compliant with this area of the Internal Revenue Code.

LSC Management responded that once the Office of Legal Affairs (OLA) completed its analysis of the use of consultants and the Office of Inspector General (OIG) completed its review of LSC's contracting practices, LSC will obtain advice from outside counsel and make any necessary modifications to its practices. In April 2009, LSC Management indicated that outside counsel was currently analyzing this issue.

In 1995 the OIG issued an inspection report entitled "Contract Service and Related Expense Payments." The report recommended that "...the Corporation review its practices with respect to classification of independent contractors to ensure that such practices comply with the Internal Revenue Code and the Corporation's policies." The LSC Management response indicated that it took action to reclassify one independent

contractor as an employee and "...would also consult tax counsel with regard to classification of other consultants." LSC researched its records and has not been able to locate any analysis prepared by outside tax counsel related to this issue.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the audit were to determine whether appropriate internal controls over consultant contracts were in place and properly followed, and to determine whether consultant contracting actions were in compliance with applicable laws, regulations, and LSC policies and procedures.

To accomplish our objectives, the OIG reviewed the internal controls over the award and administration of consultant contracts. To obtain an understanding of these internal controls, the OIG reviewed LSC policies and procedures, including any relevant manuals, guidelines, memoranda, emails, and directives setting forth current LSC practices.

The OIG interviewed LSC officials to obtain an understanding of the internal control framework and the officials' knowledge and understanding of the processes in place. Applicable laws and regulations pertaining to LSC contracting were reviewed. In addition, Federal contracting policies were reviewed, such as the Federal Acquisition Regulations (FAR), to identify best practices that could be adopted by LSC.

A judgmental sample of 38 consultant contracts for which LSC made payments in FYs 2007 and 2008 was selected for review.¹ Documentation maintained in contract files was reviewed and LSC officials were interviewed in order to assess compliance with LSC policies and procedures. The OIG relied on LSC's Transaction Listing By Account Report – Consultant Account – to identify the universe of consultant contracts from which a sample was selected. (Audit tests were not performed on the general or application controls over the automated system that produced the reports.) Retainer agreements with outside counsel were excluded from the sample. The sample of 38 consultant contracts represented approximately 10 percent of the approximately 350 consultant contracts for which LSC made payments in FYs 2007 and 2008.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence

¹ One of the contracts was entered into in October 2008 (FY 2009). Because the contract was being processed in FY 2008 and the contract was relevant to issues raised in this report, it was included in our sample. OIG consultant contracts were not included in the sample in order to comply with generally accepted auditing standards relating to independence.

obtained provides a reasonable basis for our findings and conclusions based on the audit objectives. The audit field work was conducted from January to April 2009.

OVERALL EVALUATION

Controls over consultant contracts were generally adequately designed; however, application of the controls was not enforced. Revisions to LSC's written procedures are needed to strengthen internal controls and to clarify existing procedures. While LSC's written policies and procedures over the consultant contracting process were generally adequate, LSC's consultant contracting practices did not regularly follow those policies and procedures, resulting in instances of noncompliance.

Specifically, LSC did not follow required internal controls, such as obtaining appropriate signatures on Contract Approval Forms, issuing purchase orders as prescribed, and maintaining contract-related records in the proper files. Contrary to LSC policy, consultant contracts were awarded without either engaging in competition or documenting the applicable exceptions to the competition requirement. Additionally, contracts were executed without obtaining the required approvals and/or without including all required information in contracts. Instances of noncompliance resulted from LSC officials responsible for consultant contracting actions often following past contracting practices without regard to whether the actions complied with current written policies and procedures.

The OIG recommends that LSC Management:

- Strengthen the existing internal control structure to assure its current policies and procedures are followed,
- Make the necessary revisions to Chapter 1 of the Administrative Manual to clarify the policies and procedures to be used by all LSC personnel involved in the consultant contracting process, and
- Implement additional policies and procedures to strengthen internal controls over the contracting process to: document the basis for contract decisions, ensure adequate acquisition planning, and prohibit duplicate payments to LSC program employees.

RESULTS OF AUDIT

The results of the audit and corresponding recommendations are addressed in the following sections of this report:

- I. Internal Controls Over Contracting Actions
- II. Compliance With LSC Contracting Policies and Procedures

I. INTERNAL CONTROLS OVER CONTRACT ACTIONS

LSC needs to implement additional procedures to strengthen internal controls over consultant contract actions. The OIG identified three areas that need improvement. A discussion of these areas and the corresponding OIG recommendations are included in this section under the following captions:

- A. Documenting Contract Decisions
- B. Evaluating Contract Alternatives
- C. Establishing Additional Controls Over Contract Payments

A. Documenting Contract Decisions

LSC may have entered into independent contractor agreements with individuals who should have been classified as employees under IRS rules. As a result, LSC could be liable for fines, penalties, and additional payments to workers.

LSC routinely enters into independent contractor agreements with workers to assist OPP and OCE fulfill their missions. In 1993, the then Office of Monitoring, Audit and Compliance (MAC) provided its rationale supporting the position that the workers should be classified as independent contractors. OLA² stated in memoranda that it could not agree with MAC's position. Documentation was not provided as to how the legal issues raised by OLA were addressed. Also, for two specific agreements reviewed during this audit, OLA stated concerns as to whether these two workers, under IRS rules, should be considered employees rather than independent contractors. LSC management provided its rationale for entering into the agreements. However, the rationale did not address the concerns raised by OLA.

As a good business practice, especially for organizations receiving public funding, the basis for decisions on contracts should be fully documented and transparent. LSC's Administrative Manual requires that a complete history of the contracting transaction be included in the file. Documenting in the contract file the comments received in the proposed contract review process and how these comments are resolved is part of the complete history.

The FAR provides guidance on the types of information that should be documented in contract files. While LSC is not required to follow the FAR, it does contain requirements that LSC could use as best-practice guidance. The FAR requires that "service contracts should have documentation in the file that has the opinion of legal counsel and a memo of facts and rationale that supports the contract decision."

² The Office of Legal Affairs (OLA) was previously named the Office of General Counsel.

For the 2-year period ending September 30, 2008, LSC entered into as many as 200 independent contractor agreements that may be more appropriately classified as employee agreements under IRS rules, based on LSC documented analyses of worker categories. According to LSC officials, LSC has entered into these types of independent contractor agreements for over 15 years.

The issue of determining whether workers should be classified as independent contractors or employees in accordance with IRS rules is complicated and fact-driven. IRS guidelines include 20 factors that should be considered in making the determination. According to the FY 2008 annual financial statement audit of LSC, this issue has been debated within LSC for years. However, even though the debate has been continuing and the issue considered unresolved, LSC has continued to make decisions to classify workers as independent contractors rather than employees without appropriately documenting the rationale for its decision.

In response to our request for documentation supporting the decision to treat workers as independent contractors versus employees, LSC management stated that the decision was made prior to 1993 and apparently reaffirmed in 1993 or shortly thereafter. LSC provided documented analyses dating back to 1992 that support both sides of the issue. However, LSC has not been able to provide documentation that specifically addresses the concerns raised by OLA. Appendix I summarizes the relevant documentation on this issue dating back to 1992.

LSC management's practice of not documenting its rationale for making decisions may have left LSC vulnerable for the payment of fines and penalties to IRS should LSC be found to have misclassified workers. IRS safe harbor provisions provide relief to organizations from fines and penalties if the organizations can satisfy a reasonable basis test. Documenting its decisions could help LSC meet this reasonable basis test.

If LSC incorporated and followed policies and procedures, similar to those in the FAR that explicitly require the rationale for contract decisions be documented in contract files, then it would have had greater assurance that its interests were protected and contract actions were proper. OLA opinions on proposed contract actions as well as any LSC management decisions to not follow the opinions would have been required to be documented in the contract files.

Recommendations

To ensure that the issue of independent contractor versus employee is resolved and contract actions fully documented, the Chief Administrative Officer (CAO) should implement the following recommendations:

Recommendation 1. Ensure that the issue of the status of LSC consultants as independent contractors versus employees is resolved expeditiously or file an SS-8 with IRS to obtain an administrative determination of the proper

classification of its consultants under IRS rules if the issue cannot be resolved quickly through other means.³

LSC Management Comments.

LSC has obtained the assistance of outside counsel on a *pro bono* basis to review the classification of consultants used by the Office of Program Performance (OPP) and the Office of Compliance and Enforcement (OCE). Based on the recommendations of outside counsel, we are making modifications to the classification, and expect to have all modifications made by October 1, 2009. To the extent that OCE and OPP consultants are reclassified as temporary employees, many of the recommendations of this audit with respect to OPP and OCE consultants will be rendered moot.

OIG Evaluation of LSC Management Comments:

Management stated that the modifications to the classification, based on outside counsel recommendations, are expected to be made by October 1, 2009. The OIG has not been provided a copy of the outside counsel's opinion nor informed of the specific planned modifications. Both the opinion and the modifications made will be needed in order for the OIG to fully evaluate management actions as well as for LSC management to fully document key decisions and ensure future compliance with the law⁴. Management comments do not specifically indicate what actions, if any are going to be taken to remedy those cases where individuals may have been misclassified as independent contractors. Determining and acting upon the remedial actions are necessary to resolve this issue.

The OIG disagrees with management's statement that, "To the extent that OCE and OPP consultants are reclassified as temporary employees, many of the recommendations of this audit with respect to OPP and OCE consultants will be considered moot." The OIG will not consider any of the recommendations moot since they apply to all future OCE and OPP consultant contracts. Also, recommendations such as documenting key decisions and complying with LSC policies and procedures will apply to all future agreements with temporary employees.

³ The January 6, 2009 IPA audit of LSC's 2008 financial statements includes a similar recommendation.

⁴ Reliance on the advice of counsel may provide a "reasonable basis" for a taxpayer's misclassification of employees as independent contractors, making the taxpayer eligible to qualify for a safe harbor provision contained in the Internal Revenue Code. See Select Rehab., Inc. v. United States, 205 F. Supp 2d 376, 383 (M.D. Pa. 2002).

The OIG considers this recommendation open pending its review of the outside counsel's opinion, the modifications made by management, and the actions taken to address previous misclassifications.

Recommendation 2. Include a requirement in Chapter 1 of the LSC Administrative Manual that the rationale supporting contract decisions be clearly documented in contract files, including addressing any concerns raised in the review of proposed contract actions.

LSC Management Comments:

A requirement will be included in Chapter 1 of the Administrative Manual that the rationale supporting contract decisions be clearly documented in contract files.

OIG Evaluation of LSC Management Comments:

Open. The OIG will review the required language in the Administrative Manual before closing this recommendation.

B. Evaluating Contract Alternatives

LSC does not prepare acquisition plans that address the feasibility of contracting alternatives. Such plans would provide LSC the assurance that its level of consultant contracting is appropriate.

While LSC's Administrative Manual does not require the preparation of an acquisition plan, the FAR requires agencies to prepare such a plan at least once per year. The FAR suggests that acquisition planning begin as soon as agencies' needs for outside services are identified; preferably well in advance of the fiscal year in which the services of consultants are necessary. One of the elements of an acquisition plan, according to the FAR, is the documentation of a statement of need that discusses acquisition alternatives and any related in-house efforts.

Many LSC consultant contracts are for services that are also carried out by LSC employees, such as OPP and OCE program visits. In deciding the level of contracting for these types of services, LSC would be well-served to develop an acquisition plan that evaluates the extent to which contracting alternatives could be pursued, such as interchanging LSC staff for consultants.

LSC officials explained that LSC does conduct planning in advance of program visits as well as planning for the level of consulting needed at the time the LSC budget is being developed. However, developing a more detailed annual acquisition plan that evaluates

alternatives could provide a number of benefits to LSC. Such a plan could accomplish the following:

- Assess on an annual basis the anticipated use of consultants to supplement the LSC workforce and determine whether the hiring of staff would be a more appropriate alternative for meeting LSC's needs.
- Allow the necessary time to follow LSC's competition requirements, such as developing statements of work and advertising for qualified consultants.
- Assess whether in-house alternatives could be used, such as interchanging and training OCE and OPP staff for the varied program visits.
- Evaluate the degree to which the scope or length of program visits could be adjusted to accommodate in-house staffing or how the use of technology could assist in reviewing programs and reduce consulting costs.

LSC program visits have often been carried out by LSC employees and consultants. The program visit in 2008 by OPP to the Legal Services of New York program used eight OPP staff and eight consultants at a contracting cost of approximately \$50,000. An annual acquisition plan that evaluated alternatives and documented the justification for the level of contracting on this type of visit as well as other visits could provide LSC additional assurance that its needs are being met in the most effective, economical, and timely manner.

Recommendation 3. To ensure that LSC's strengthens its controls over acquisition planning, the CAO should implement policies and procedures that require an annual acquisition plan that, at a minimum, identifies needs, evaluates possible alternatives to contracting and documents the level of consultant contracting required for the year for OCE and OPP grantee visits.

LSC Management Comments:

OPP and OCE have been preparing, as part of the budget process, a plan for the number of consultants needed each year to assist with program visits. The offices also project their needs for any additional consultants as part of their projection for the consultant line items of their budgets. The Vice President for Programs and Compliance reviews and approves these projections. This process produces the same information, in another format, as would be produced by an acquisition plan for consulting services. Regarding the consideration of alternatives to the use of consultants, both offices use different consultants depending upon the needs of any given program visit. Past consideration of hiring additional staff rather than using consultants has determined

that LSC cannot obtain in one staff person the range of skills needed for the different visits. Also, on a cost basis, the use of consultants has proved more economical than the addition of full-time staff. Rather than duplicate the information developed in our budget process as part of an acquisition plan, OPP and OCE will continue to make annual projections for the need for consultants, and LSC Management will periodically review the economics and practicality of hiring additional staff as an alternative to the use of consultants.

OIG Evaluation of LSC Management Comments:

Open. LSC's alternative approach to resolving this recommendation indicated that management would periodically review the economics and practicality of hiring additional staff as an alternative to using consultants. The OIG cannot adequately evaluate management's alternative actions because the budget information that management refers to in its comments has not been provided to the OIG. Once the budget information and the opinion from the outside counsel are provided, the OIG will assess management's corrective actions.

C. Establishing Additional Controls Over Contract Payments

LSC policy and practice is to prohibit consultants from receiving compensation from any other LSC-funded source for any hours of a working day for which they are engaged with LSC. More specifically, LSC requires that LSC grantee employees only be compensated by LSC while they are on leave without pay from the grantee. While LSC did not always follow this policy and did not have sufficient controls in place to monitor and enforce the policy, it has taken positive measures to ensure compliance with the policy. However, LSC needs to take additional steps to ensure that consultants have not received double compensation from LSC and its grantees.

OPP and OCE consultant agreements state, "Consultants are not entitled to claim compensation for services for any hours of a working day for which they have received compensation from any other LSC-funded source. If your request is paid in violation of this provision, the Legal Services Corporation will recover such compensation."

LSC and consultants did not always comply with LSC's policy to restrict consultants' compensation. Modifications to common contract language were made to consultant agreements to allow double compensation.

In 2 of 38 contracts in our sample, the standard language was modified to allow consultants to receive compensation from LSC and other LSC-funded sources. The modification stated, in addition to the language noted above, "For purposes of this paragraph, "compensation from any other LSC-funded source" does not include payment to a consultant by his or her employer for any accrued leave." For both

modified contracts, Office of Human Resources (OHR) noticed the modification after the contracts were executed and was able to resolve the issue by executing amended contracts that contained the standard language. LSC officials stated that they have been aware of other instances of the standard language being modified for contracts not in our sample.

LSC has since taken steps to ensure that its compensation policy is being followed. LSC changed its practice to require that only OHR prepare and modify OPP and OCE consultant agreement letters. LSC is also requiring that consultants certify to compliance with the compensation terms. The certification reads:

I certify that I will be on leave without pay status from (*program name*) on the days I am performing services for LSC pursuant to this contract. I will not receive funds from (*program name*) or any other LSC funded source for the days on which I am compensated by LSC.

These steps should strengthen the internal controls to ensure that, in the future, consultants will comply with the contract term implementing LSC's policy on compensation. However, LSC did not have sufficient controls to ensure that, in view of the confusion surrounding the issue, consultants are not receiving double compensation from LSC and an LSC-funded source.

Recommendations

To ensure that LSC's policy to preclude the compensation of contractors who also receive compensation from an LSC-funded source is being followed, the CAO should implement the following recommendations:

Recommendation 4. Revise the Administrative Manual to include the currently used certification clause as required information for consultant contracts.

LSC Management Comments:

The Administrative Manual will be revised to include a certification clause as required information for OPP and OCE consultant contracts.

OIG Evaluation of LSC Management Comments:

Open. The OIG will review the required language in the Administrative Manual before closing this recommendation.

Recommendation 5. Develop procedures to ensure that LSC contractors are not receiving compensation from an LSC-funded source for any hours of a working day for which the contractors are engaged with LSC.

LSC Management Comments:

LSC will develop a procedure to verify that OPP consultants, while performing contractual work for which LSC is paying, receive no other compensation from LSC funds.

OIG Evaluation of LSC Management Comments:

Open. While the OIG considers management's intention to establish procedures as responsive, the recommendation is open until the new procedures have been developed and implemented and evidence of such has been provided to the OIG.

II. COMPLIANCE WITH LSC CONTRACTING POLICIES AND PROCEDURES

LSC needs to improve its compliance with policies and procedures over the consultant contracting process. Specifically, the OIG identified that:

- A. Contracts were not awarded competitively;
- B. Required approvals were not obtained;
- C. Required basic information was not used in contracts;
- D. Contract Approval Forms were not properly used;
- E. Purchase Orders were not always prepared; and
- F. Contracting records were not properly maintained.

Detailed findings for each area are presented below. Recommendations addressing these findings are presented at the end of this section.

A. Contracts Not Awarded Competitively

LSC has established policies and procedures for the competitive award of contracts. However, for most contracts reviewed, LSC neither competitively awarded the contracts nor documented the reasons for not using competition as required. By disregarding its policies and procedures, LSC cannot be assured that contracts are awarded based on the best value to LSC.

Competition Requirements

According to the LSC Administrative Manual,

Key to ensuring that LSC funds are expended in an efficient and effective manner is the requirement that all services be obtained for the best evaluated price and terms. Contracts shall be awarded based on the best value to LSC. Best value as used in the manual is the most advantageous

balance of price, quality, and performance achieved through competitive procurement methods in accordance with stated selection criteria. Competition is an integral component of this requirement.

The LSC Administrative Manual provides a dollar threshold for the type of competition required.

- For contracts for service with a cumulative cost between \$3,500 and \$10,500, solicitation of proposals via the internet, email or telephone contacts is required from not fewer than three sources.
- For contracts for service with a cumulative cost exceeding \$10,500, receipt of at least three proposals submitted in response to a request for proposals (RFP) is required.

The LSC Administrative Manual allows exceptions to the competitive proposal procedures. It requires that before any of the exceptions are exercised, the appropriate LSC official shall clearly document for the file the reasons for the exception and obtain approval from the President. Similarly, the FAR requires reasons for exceptions be documented, but the FAR also requires specific information be included in the justification for the exception. The FAR requires, at a minimum, each justification include the following information:

- A demonstration that the proposed contractor has unique qualifications;
- A description of efforts made to ensure that offers are solicited from as many potential sources as practicable; and
- A determination that the anticipated cost will be fair and reasonable.

Requirements Not Followed

In our sample, 37 of 38 consultant contracts exceeded the threshold for competitive awards. However, only one of them was awarded competitively and, except for one contract, LSC was unable to provide us with documented justifications for exceptions to the competitive proposal procedure.

For the consultants used by OCE and OPP for grantee visits, LSC did advertise for potential consultants and follow a prequalification process on the potential consultants. However, the competitive award policies and procedures were not followed in that offers were not solicited based on stated selection criteria.

In September 2006, OCE advertised in the Washington Post for potential consultants to submit their resumes and attend an orientation session. After reviewing resumes and conducting an orientation, OCE developed a list used to make consultant selections. However, the basis for selection of the final pool of consultants from the orientation attendees and selections from the final consultant pool for grantee visits were not documented.

OPP had a similar process using email sent to all program Executive Directors and from the responses, a list of potential consultants was established. The basis for the selections from this list for the grantee visits was not documented in contract files.

Even though LSC advertised for consultants, the consultant contracts in our sample had not resulted from full and open competition. The final consultant pool was comprised of a limited number of consultants that did not submit proposals for LSC to evaluate and select the best value to LSC; rather, consultants were compensated at a rate set by LSC Management. By not complying with competition procedures LSC cannot be assured it is receiving best value as defined in its contracting policies.

LSC officials stated that they did not compete the OCE and OPP consultant contracts because when Chapter 1 of the Administrative Manual was being revised in 2005, LSC intended for these types of contracts to be exempt from such competition. According to these officials, in the editing process the blanket exception was removed. Currently, the Administrative Manual requires competition for consultant contracts and provides for exceptions to competition on individual contracts. LSC did not compete 37 of the 38 contracts in our sample, nor was the individualized exception process implemented for 36 of the 37 contracts that were not competed.

Competing contracts helps ensure that LSC receives best value in accordance with its policies. Fully documenting exceptions to its competition requirements helps improve internal controls and ensure that the contracting process is not abused.

B. Required Approvals Not Obtained

LSC policies and procedures set out the required approval process for consultant contracts. As detailed below, LSC did not follow these policies and procedures for the consultant contracts in our sample. As a result, LSC may be at risk for issuing contracts for other than the desired service LSC is seeking and vulnerable to excessive contract costs.

LSC's Administrative Manual addresses approvals for consultant contract actions under Chapter 1, Part III, Paragraph A-5, which states:

Prior to the award of a contract for a consultant, the originator of the contract must present the contract to the Director of the Office of Human Resources for review. The Director will then obtain the President's approval for hiring a consultant for the proposed project. If the contract is in accord with the standard consultant contract previously approved by the Office of Legal Affairs and at the standard rate for consultants, the Director of Human Resources shall approve the contract. If the contract deviates from the standard contract previously approved by the Office of Legal Affairs, the contract must be presented to the Office of Legal Affairs for

review and the procedure in paragraph 4 above [setting out the procedure for approval of contracts] shall be followed. If the consultant contract is for an amount other than the standard consultant rate, the contract shall be presented to the Comptroller for approval.

LSC did not fully comply with the approval requirements in this paragraph.

- For 37 of 38 consultant contracts in our sample, the LSC President's approval was not obtained. An LSC official stated that in 2005 the President delegated the responsibility for reviewing and approving the consultants used by OPP and OCE to the Vice President, Programs and Compliance. However, the LSC Administrative Manual was not updated with this change.
- For all consultant contracts in our sample, a standard contract was used for OCE contracts and a standard contract was used for OPP contracts. However, it was unclear whether and when either contract had been reviewed by OLA. OLA has not officially approved a standard consultant contract. Some LSC management officials indicated that they were unaware that OLA had not approved the standard contracts. According to LSC officials, over time OLA reviewed and commented on individual OPP and OCE contracts and at some point a reviewed contract from each office was assumed by operating personnel to be the standard OLA-approved contract. The assumed OLA-approved consultant contracts were then used for all the OPP and OCE contracts in our sample.

Chapter 1, Part III, Paragraph A-5 only requires OLA and the Comptroller review on an exception basis. For those consulting contracts not meeting these exceptions, paragraph A-5 does not make reference to other approval requirements in LSC's Administrative Manual (as presented below); however, neither does it specifically exempt consultant contracts from other approval requirements, particularly those that require a review by OLA or the Comptroller. Chapter 1, Part III of LSC's Administrative Manual describes the approval process for all contracts for services in the following paragraphs:

- Paragraph A-1b, Legal Sufficiency Review, states that "The Office of Legal Affairs must approve contracts for form and legal sufficiency before they are awarded."
- Paragraph A-1c, Comptroller Review, states that "The Comptroller must approve all contracts before they are awarded to ensure that the requirements of this Chapter have been followed prior to the award of the contract and the preparation of a purchase order."
- Paragraph A-4, Approvals of Contracts Prior to Award, states "Prior to the award of any contract, the originator of the contract must obtain the review of the Office of Legal Affairs, and the Comptroller and the approval of the Director of the originating Office for contracts under \$3,500, the Vice President or CAO for the originating Office of contracts greater than \$3,500 and of the President for

contracts greater than \$10,500.... Without these approvals the contract cannot be awarded and the Comptroller shall not issue a purchase order.”

Proper approvals are necessary controls to protect LSC’s interests. Also, clearly defined requirements ensure that the approval process is understood and that proper approvals are obtained.

C. Required Basic Information Not Used In Contracts

LSC’s Administrative Manual provides a description of the basic information that is required to be included in all contracts. Much of this required information was not included in the contracts reviewed. LSC’s practice of not submitting proposed consultant contracts for OLA’s review may have contributed to this condition. Issuing contracts without the required basic information leaves LSC vulnerable to disagreements and additional costs.

LSC’s Administrative Manual’s description of the basic information required for all contracts for services includes such items as:

- A clear, complete, and concise description of the specific services or tasks to be performed;
- The cost basis for the contract;
- A schedule for completion of the work and a statement of the term of the contract;
- A termination clause;
- Provisions for invoicing and payment, amendments to the contracts, indemnifications, severability and applicable laws; and
- Provisions on subcontracting, confidentiality, and intellectual property rights.

For 32 of 38 of the contracts sampled, at least one or more of the provisions required by the Administrative Manual were missing from the contract. Examples include:

- Fourteen of the 38 contracts sampled stated that consultants were to “participate on teams” rather than providing a clear, complete and concise description of the specific services to be provided as required.
- Thirty of the 38 contracts sampled did not specify when the work has to be completed or submitted. Or, when a contract stated that “LSC has to receive a written report ... within seven (7) days...” it was not specific as to what event would trigger the number of days mentioned. The wording was vague and open to interpretation.
- Contracts did not include the terms of the contract (1 of 38); a termination clause (16 of 38); and provisions for amendments (31 of 38); subcontracting, confidentiality, and intellectual property rights (31 of 38).
- Thirty of the 38 contracts sampled were missing statements regarding indemnifications, severability and the applicable laws.
- In one case, an email was used as a contract in lieu of a contract with signatures.

- The OPP and OCE contracts enclosed timesheets for completion and submission by the consultants. However, the contracts did not indicate a deadline for the submission of these timesheets. As a result, one OPP consultant submitted timesheets and expense reports fifteen months after the work had been completed. The Comptroller's office personnel indicated that this was not an isolated event; rather timeliness in submission of expense reports has been a long-standing issue.

A primary reason for contracts being awarded without required information is that OLA does not routinely review consultant contracts. The Administrative Manual only requires that consultant contracts are "in accord with the standard consultant contract previously approved by OLA." However, as previously discussed, it is not clear the extent to which OLA had reviewed the standard consultant contract. According to OLA officials, the use of a previously executed contract or a form contract, regardless of whether it has been reviewed in the past, does not provide LSC the same level of protection as a review for legal sufficiency of a specific proposed contract. Had OLA routinely reviewed the proposed consultant contracts and identified information that should be included in the contracts, then LSC could have made revisions to the contracts before they were awarded.

At our request, OLA reviewed the consultant contracts currently being routinely used by OCE and OPP. OLA identified the kinds of provisions that it might ordinarily suggest for consideration in the drafting of such contracts in order to provide maximum protection for LSC. OLA had recommendations for improvements to the standard contracts related to 7 of the 12 provisions listed in the Administrative Manual as basic information to be included in all contracts. OLA also had recommendations for improvements related to four other provisions not listed in the Administrative Manual dealing with the following subjects: integration clause; representations and warranties; clarification of consultants' relationship with LSC; and anti-competition clause.

Issuing contracts without important basic information that must be included in consultant contracts could lead to disagreements with the parties involved, which may not adequately protect LSC's interests. OLA's review and evaluation for the contract's form and legal sufficiency provides LSC a valuable internal control to ensure required information is included in consultant contracts.

D. Contract Approval Form Not Used

LSC policies and procedures require completion of the Contract Approval Form prior to LSC awarding a contract. This form documents required approvals and the completion of key steps in the contracting process. LSC officials did not complete the form for the contracts in our sample and, as a result, lost the benefit this internal control could have provided.

The Contract Approval Form, if properly used, serves as useful internal control over the contracting process. LSC's Administrative Manual, Chapter 1, addresses its use in several places.

- Part I, Definitions and Policies, states, "The Contract Approval Form is the form that must be executed by the originator of the contract and signed by the General Counsel or his Designee and Comptroller prior to LSC awarding a contract."
- Part III, Approval of Contracts Prior to Awards, states "...the originator of the contract shall transmit the proposed contract with a completed Contract Approval Form..."
- The Contract Originator's Contracting Procedure Outline describes the specific requirements for contract originators in using the Contract Approval Form in steps 6, 7, and 9 of the Outline.

The Contract Approval Form, which is used for procuring both goods and services, requires, among other things, the following:

- Certification that the following required steps have been taken:
 - Use of the General Services Administration Schedule for solicitation of bids/proposals;
 - Positive efforts were made to utilize Small and Disadvantaged Business Enterprises;
 - A minimum of three proposals were solicited and received (for goods over \$1,500 or services over \$3,500);
 - An RFP was issued to solicit proposals (contract valued at over \$10,500); or competitive bidding was used to solicit bids (procurement valued at over \$7,500).
- An explanation if any of the above certifications are not checked.
- Initials and date for approval of the Office of Legal Affairs for form and legal sufficiency.
- Initials and date for approval of the Comptroller for procedural sufficiency.
- Initials and date for approval of the President (if applicable).

LSC did not complete the Contract Approval Form and maintain it as supporting documentation for any of the consultant contracts in our sample of 38. Although not described in the Administrative Manual, the practice in OPP and OCE was for the contract originators to complete a Consultant Request Form and forward it to OHR to prepare the contract agreement letter. The Consultant Request Form only requires information necessary to prepare the contract such as the project description, consultant's information, duration of the contract, and standard language to be used, but does not require the same certifications and approvals as the LSC Contract Approval Form, as described above.

The Contract Approval Form should have been used for all proposed consultant contracts. Without the use of this internal control, LSC does not have assurance that required steps and approvals have been performed for consultant contracts, leaving LSC open to the noncompliance issues noted in previous sections of this report.

E. Purchase Orders Not Prepared

LSC policies and procedures require the issuance of a purchase order once a contract has been properly executed. LSC did not issue purchase orders for 22 of 38 contracts in our sample and did not have procedures in place to confirm that contracting procedures were being followed before purchase orders were issued. As a result, LSC funds have been committed and expended without ensuring that contracts were properly executed.

LSC's Administrative Manual defines a purchase order as a form that serves as the control for the commitment of funds and the payment of invoices, except for petty cash and legal representation contracts. The Administrative Manual further states that a purchase order should only be issued after the Comptroller's Office has confirmed that the requirements of chapter 1 of the Administrative Manual have been followed and that the contract has been properly executed. Payment of invoices before the purchase order has been approved and a purchase order number assigned is not permitted. See Appendix II for the paragraphs from the Administration Manual that describe the purchase order process.

LSC did not issue purchase orders for 22 of 38 contracts in our sample. The Comptroller's Office implemented a new accounting system in May of 2008. Under the previous accounting system only one purchase order was issued out of 23 contracts in our sample pertaining to that period. Comptroller's Office staff did complete a Contract Control Form for contracts issued under the previous accounting system; however, the form did not provide the same level of control as a purchase order. For example, use of the Contract Control Form does not result in control numbers being assigned as required by the Administrative Manual for purchase orders. Under the new accounting system, purchase orders were issued for all 15 contracts in our sample pertaining to the period the system was operational.

However, under both accounting systems, contracts were not properly reviewed to ensure that they were properly executed prior to issuing purchase orders because LSC did not have a process to do so. Under the new accounting system, once a contract is awarded, it is forwarded to the accounting clerk to issue a purchase order. The Comptroller's Office staff did not review the contracts to ensure compliance with the requirements of Chapter 1 of the Administrative Manual. The Comptroller's Office staff did not verify that approvals were received, that competition was performed, or that justification for exceptions was documented. The required compliance check was not performed by Comptroller's Office staff because of the assumption it was completed prior to reaching purchase order issuance stage as required by the Administrative Manual. Under the old accounting system, the verification process was similarly lacking.

Not following the required review procedures prior to issuing purchase orders can compromise a key internal control for ensuring that contracts are properly executed. By way of example, two contracts in our sample were executed and paid without the signature of a representative of OHR as required. Both contracts were executed by only the approval and signature of the Director of the originating office. Notation on both contacts indicated that this practice also occurred on other contracts not in our sample. Reviewing whether contracts have been properly executed before issuing purchase orders could identify and correct these types of deficiencies.

F. Contracting Records Not Managed Properly

LSC policies and procedures require contract files be sufficient to constitute a complete history of the transaction. Contract originators are required to promptly forward supporting documentation to the Comptroller's Office upon awarding contracts. LSC did not follow this policy and procedure for contracts in our sample. As a result, contracting records were not always complete or available.

The LSC Administrative Manual describes the contracting records that are required to be forwarded to the Comptroller's Office for all LSC contracts for services. These records include a copy of the contract, Contract Approval Form, RFP, copies of proposals received (as applicable), amendments, and invoices.

For the contracts in our sample, the following contractor records were not included in the Comptroller's Office contract files.

- Copies of two contracts.
- Copies of proposals received on one contract. (As discussed earlier, LSC only solicited proposals for one contract in our sample.)
- Contract Approval Forms for all contracts in our sample. (As discussed earlier, LSC was not using these forms. Other contract request forms that are being used by OCE and OPP were not included in the Comptroller's Office files.)

In addition to the records listed above, the LSC Administrative Manual describes other procurement and contract records that are required but does not specifically state that these should be maintained in the Comptroller's Office contract files. Part I, Paragraph C-3, Procurement and Contracting Records, states that, "Records relating to procurement and contracting activities shall include, at a minimum, the basis for contractor/vendor selection and justification for lack of competitive bidding or proposals (as applicable). Documentation in the files shall be sufficient to constitute a complete history of the transaction." A description of what constitutes "a complete history of the transaction" is not provided in the Manual.

Without specifying in the Administrative Manual what contracting records should be maintained and identifying what office should maintain these records, LSC cannot be assured that contract records are properly maintained. However, looking to other

contracting regulations for guidance, the FAR provides examples of the type of contract files maintained and the records that are normally contained, if applicable, in contract files⁵.

Recommendations

The CAO should make the following revisions to Chapter 1 of the LSC Administrative Manual to clarify the policies and procedures to be used by all LSC personnel involved in the consultant contracting process:

Recommendation 6. Provide a clear description of what should be documented in a justification for not awarding consultant contracts competitively including

- A demonstration that the proposed contractor has unique qualifications,
- A description of efforts made to ensure that offers are solicited from as many potential sources as practicable, and,
- A determination that the anticipated cost will be fair and reasonable.

LSC Management Comments:

The Administrative Manual will be revised to provide a clear procedure for contracting for consultants for OPP and OCE, including clear instructions as to when competitive bidding must be used and what criteria must be met when competitive bidding is not used. A prior version of the Administrative Manual had a special provision governing OPP and OCE consultant contracts, and we anticipate reinstating a revised version of that provision.

OIG Evaluation of LSC Management Comments

Open. The OIG will review the required language in the Administrative Manual before closing this recommendation.

⁵ The FAR lists the following documents as examples of records normally maintained in contract files. The FAR also identifies the office within which these records are typically maintained:

- Purchase request, acquisition planning information, and other presolicitation documents
- Evidence of availability of funds
- The list of source solicited
- The organization's estimate of contract price
- A copy of the solicitation and all amendments thereto
- A copy of each offer or quotation
- Source selection documentation
- Justification for the type of contract
- Required approvals of award and evidence of legal review
- Notice of Award
- The original of copy of the signed contract or award, all contract modifications, and documents supporting modifications executed by the contracting office.

Recommendation 7. Require that all proposed consultant contracts be approved by OLA and the Comptroller's Office.

LSC Management Comments:

The Administrative Manual currently requires that all contracts be reviewed by the Office of Legal Affairs (OLA) and the Comptroller. For OPP and OCE contracts, a standard contract is used. We will assure that OLA and the Comptroller approve the standard contract and that any modifications to the standard contract are approved by the appropriate official.

OIG Evaluation of LSC Management Comments:

Open. Once a standard contract, approved by OLA and the Comptroller, is modified, it is no longer a standard contract and should go through the appropriate review process. The OIG considers recommendation 7 open until the standard contracts are properly approved and the OIG reviews any necessary revisions made to the Administrative Manual.

Recommendation 8. Evaluate and consider adding to the description of required information for all contracts provisions dealing with integration clause; representations and warranties; clarification of consultants' relationship with LSC; and anti-competition clause.

LSC Management Comments:

LSC will review the additional four contract provisions identified and will add those found to be relevant.

OIG Evaluation of LSC Management Comments:

Open. The OIG will review the clauses found to be relevant by management before closing this recommendation.

Recommendation 9. Require that the Contract Approval Form be used for all proposed consultant contracts.

LSC Management Comments:

The Administrative Manual requires that the contract approval form be used for all contracts. The revised Administrative Manual provision for OPP and OCE consultant contracts will address this issue.

OIG Evaluation of LSC Management Comments:

Open. The OIG will review the required language in the Administrative Manual before closing this recommendation

Recommendation 10. Require that a review process be implemented that ensures contracts are properly executed before purchase orders are issued.

LSC Management Comments:

The Comptroller's Office has instituted a new procedure for purchase orders. That process includes a provision that contracts be reviewed for proper executive prior to purchase orders being written.

OIG Evaluation of LSC Management Comments:

Closed. Management actions taken address the issues raised.

Recommendation 11. Specify the consultant contract-related records that need to be maintained in contract files and identify the office(s) that should maintain these records.

LSC Management Comments:

We will specify in the Administrative Manual which consultant contract records must be maintained and where they are to be maintained.

OIG Evaluation of LSC Management Comments:

Open. The OIG will review the required language in the Administrative Manual before closing this recommendation.

The CAO should implement the following recommendations to strengthen an internal control structure that assures LSC consultant contracting policies and procedures are followed:

Recommendation 12. Provide training on the policies and procedures in Chapter 1 of the LSC Administrative Manual (after it has been revised) to ensure that all LSC personnel involved in the consultant contracting process understand their responsibilities.

LSC Management Comments:

LSC will provide training to all employees on the revised Administrative Manual.

OIG Evaluation of LSC Management Comments:

Open. The OIG will review the revised Administrative Manual and training plans before closing this recommendation.

Recommendation 13. Require periodic reporting to the LSC President of all consultant contracts executed along with the Comptroller's certification that procedural sufficiency has been attained to ensure that all policies and procedures in Chapter 1 of the LSC Administrative Manual are being followed.

LSC Management Comments:

We will adopt a reporting requirement for consultant contracts that includes a Comptroller certification and notice to the President of the Corporation.

OIG Evaluation of LSC Management Comments:

Open. The OIG will review the adopted reporting requirement for consultant contracts before closing this recommendation.

III. OIG EVALUATION OF LSC MANAGEMENT COMMENTS

Management agreed to take action on all recommendations. The OIG was not able to fully evaluate all management actions pending receipt of information, such as the opinion of outside counsel, and details regarding planned management actions. The OIG considers all recommendations open pending receipt and evaluation of additional information and management actions, with the exception of recommendation 10, which the OIG considers closed because appropriate management actions were completed.

The OIG's evaluation of management comments for each recommendation can be found in the body of the final report following the associated recommendation and management comments sections. The full text of management's comments can be found at Appendix III.

Management's comment memorandum (Appendix III) also included lead-in paragraphs before addressing each recommendation and stated that the OIG "...audit report questions no costs..." While accurate, questioned cost relates to a past expenditure of funds, whereas the relevant cost issue is not what was spent in the past, but what must be spent in the future as a corrective action. For instance temporary LSC employees

may have been misclassified as independent contractors, resulting in a significant contingent liability, i.e., LSC may have to expend funds, to fully resolve any misclassification. LSC may owe Federal payroll taxes, local taxes such as unemployment, fines and penalties⁶, and employee benefit payments to the individuals who may have been misclassified. As part of resolving the issue of misclassification, LSC must determine how to correct the errors made in the past, determine what period of time needs to be covered, and determine the associated costs. These costs need to be recorded as a liability and could be material to the financial statements. Also, because these amounts may be significant, LSC management needs to determine the impact on its budget and what if any adjustments need to be made.

⁶ Because LSC has been aware of this issue since the early 1990's but has not resolved it, LSC may not qualify for the "safe harbor" provisions of tax laws, which waive fines and penalties.

Summary of Documentation Independent Contractor - Employee Issue

The following summary describes the relevant documentation reviewed by the OIG on the issue of independent contractor versus employee for a) program visits and b) two specific contracts. The summary shows that documented analyses dating back to 1992 support both sides of the issue; however, there is no definitive documentation supporting the decisions to enter into these types of agreements given the concerns raised by OLA.

Program Visits

In late 1992 and 1993, the then Office of Monitoring, Audit and Compliance (MAC) and the then Office of General Counsel (OGC) issued a series of memoranda with their analyses on this issue⁷. MAC, the LSC unit using the workers, supported the position that the workers should be classified as independent contractors (memoranda dated 2/9/1993 and 6/14/1993). OGC, the LSC legal unit, supported the position that a number of the workers should be classified as employees (memoranda dated 12/21/1992, 3/25/1993 and 7/19/1993). The latest memorandum in the series was issued by OGC and addressed MAC concerns and reiterated its position by stating:

For clarification purposes, the conclusion stated in your memorandum of February 9, 1993, and restated in your June 14, 1993 memorandum that all LSC consultants are independent contractors cannot be concurred in by OGC based on the facts provided and application of applicable law (common and statutory) to those facts.

You have also expressed concern about the suggestion in the March 25, 1993, memorandum that LSC consider whether it is desirable to file a Form SS-8 with the IRS to obtain an answer regarding the tax status of the consultants. In OGC's opinion this suggestion, i.e., to follow the administrative procedure provided by the IRS, is appropriate especially in light of LSC's continuing uncertainty about whether to treat the consultants as employees or as independent contractors.

LSC decided to continue issuing independent contracts and did not seek an answer from IRS. LSC has not been able to provide us documentation to support its rationale for the decisions given the concerns raised by OCC.

⁷ The Office of General Counsel (OGC) provided legal advice/opinions on legal matters as counsel to the Corporation. The Office of Monitoring, Audit, and Compliance (MAC) was considered part of the client and its advice/opinions did not carry the same weight as OGC's.

In 1995, an OIG report recommended that, “The Corporation review its practices with respect to classification of independent contractors to ensure that such practices comply with the Internal Revenue Code and the Corporation’s policies.”

LSC’s response to the report stated, “With respect to Recommendation 4, Management also asked outside tax counsel to review the Report’s findings with respect to the classification of the Director of OPS. Tax counsel has recommended that the Director be reclassified as an employee for tax purposes.....Management will also consult tax counsel with regard to classification of other consultants.”

LSC could not provide us with documentation concerning its consultation with tax counsel for the “other consultants.” Documentation to support LSC’s rationale for decisions on this issue should have included this tax counsel’s opinion.

In 2006, OLA prepared a 20-page analysis of this issue. The analysis stated as follows:

With respect to OCE compliance visit consultants, OPP program visit consultants and OPP competition on site evaluators and grant reviewers (other than independent review panel members), it is difficult to offer a conclusive opinion, but it appears that weighing all of the facts against the IRS criteria could reasonably lead to determination that these consultants generally are more properly classified as temporary employees and should be treated as such by LSC for tax purposes.

Since this analysis was prepared in 2006, LSC has continued to award independent contracts to the consultants described in the analysis. LSC has not been able to provide documentation to support its rationale for the decisions, especially important given the concerns raised by OLA.

Two specific contracts

As mentioned earlier, most proposed consultant agreements are not provided to OLA for review. Two specific proposed consultant agreements that were provided to OLA for review included a proposed contract with a former LSC employee for conference planning and facilitation services and a proposed contract with a former program employee with 32 years of legal experience to review reports from compliance and program quality visits. OLA, as well as others (the Comptroller on one and the Director, OHR on another), raised concerns in emails as to whether the consultants should be classified as employees rather than independent contractors. Subsequent to OLA’s email raising concerns, LSC management did cite in emails its reasons for classifying both as independent contractors but they were not forwarded to OLA to determine whether OLA would concur based on the reasons cited.

The two contracts were issued without documentation as to whether OLA had concurred with the classification of the workers as independent contractors based on the additional information cited in emails. (Had OLA received this information at the time it would not have concurred.) LSC management made the decision to classify the workers as independent contractors and explained the reasons in emails. However, for both of these contracts, LSC documentation did not support its rationale for the decisions given the specific concerns raised by OLA.

Purchase Order Requirements

The following paragraphs from the Administrative Manual, Chapter 1, describe the purchase order process.

- Part I paragraph C-5, 5. Purchase Orders, “The Office of Financial Services is responsible for preparing and executing all purchase orders. When...services rendered in accordance with the provisions of a purchase order and the invoice is verified and approved, the invoice will be processed for payment. For...contracts for which a purchase order is required, no order will be placed nor will any invoice be paid until the purchase order has been approved and a purchase order number assigned. The Office of Financial Services shall not issue a purchase order for contracts until after the required Office of Legal Affairs (OLA) approval for form and legal sufficiency has been obtained.”
- Part III paragraph A-1c, Comptroller Review, “The Comptroller must approve all contracts before they are awarded to ensure that the requirements of this Chapter have been followed prior to the award of the contract and the preparation of a purchase order. Such approval must be provided in writing by notation on the Contract Approval Cover Sheet.”
- Part III paragraph A-4a, Awarding of Contracts, “Upon the awarding of a contract by an authorized individual, a copy of the contract, along with a copy of the Contract Approval Form, and the RFP and copies of the proposals received (as applicable), must be forwarded promptly to the Office Of Financial Services. The Comptroller shall review contracts to ensure they are properly executed. Upon confirmation that a contract has been properly executed, the Comptroller’s Office shall execute a purchase order.”



MEMORANDUM

TO: Jeffrey Schanz
Inspector General

FROM: Helaine M. Barnett *HMB*
President

DATE: June 23, 2009

SUBJECT: Response to OIG Draft Report – Audit of Consultant Contracts

Thank you for the opportunity to review the Office of the Inspector General (OIG) draft report entitled “Audit of Legal Services Corporation’s Consultant Contracts” submitted to LSC management on May 26, 2009. Following is management’s response to that draft.

LSC’s executive leadership is committed to the efficient and effective management of the Corporation, including using appropriate procedures for contracting with consultants. We appreciate your review of the contracting practices and procedures currently in use and recognize the need for improvements in both. LSC began revising its Administrative Manual last year in recognition that the procedures in the manual need to be updated, and your report has further highlighted that need. We will incorporate in the revised manual the necessary changes to respond to your report, and we will train staff on the new procedures and the importance of following them. We are pleased to note that your audit report questions no costs, and we believe that our practices, while needing improvement, have delivered efficient and effective contractual services for the Legal Services Corporation.

Responses to Recommendations

Thirteen recommendations for improving our contracting with consultants are listed in your audit. The following are LSC Management’s responses to each recommendation.

Recommendation 1: LSC has obtained the assistance of outside counsel on a *pro bono* basis to review the classification of consultants used by the Office of Program Performance (OPP) and the Office of Compliance and Enforcement (OCE). Based on the recommendations of outside counsel, we are making modifications to the classification, and expect to have all modifications made by October 1, 2009. To the extent that OCE and OPP consultants are reclassified as temporary employees, many of the recommendations of this audit with respect to OPP and OCE consultants will be rendered moot.

Recommendation 2: A requirement will be included in Chapter 1 of the Administrative Manual that the rationale supporting contract decisions be clearly documented in contract files.

Recommendation 3: OPP and OCE have been preparing, as part of the budget process, a plan for the number of consultants needed each year to assist with program visits. The offices also project their needs for any additional consultants as part of their projection for the consultant line items of their budgets. The Vice President for Programs and Compliance reviews and approves these projections. This process produces the same information, in another format, as would be produced by an acquisition plan for consulting services. Regarding the consideration of alternatives to the use of consultants, both offices use different consultants depending upon the needs of any given program visit. Past consideration of hiring additional staff rather than using consultants has determined that LSC cannot obtain in one staff person the range of skills needed for the different visits. Also, on a cost basis, the use of consultants has proved more economical than the addition of full-time staff. Rather than duplicate the information developed in our budget process as part of an acquisition plan, OPP and OCE will continue to make annual projections for the need for consultants, and LSC Management will periodically review the economics and practicality of hiring additional staff as an alternative to the use of consultants.

Recommendation 4: The Administrative Manual will be revised to include a certification clause as required information for OPP and OCE consultant contracts.

Recommendation 5: LSC will develop a procedure to verify that OPP consultants, while performing contractual work for which LSC is paying, receive no other compensation from LSC funds.

Recommendation 6: The Administrative Manual will be revised to provide a clear procedure for contracting for consultants for OPP and OCE, including clear instructions as to when competitive bidding must be used and what criteria must be met when competitive bidding is not used. A prior version of the Administrative Manual had a special provision governing OPP and OCE consultant contracts, and we anticipate reinstating a revised version of that provision.

Recommendation 7: The Administrative Manual currently requires that all contracts be reviewed by the Office of Legal Affairs (OLA) and the Comptroller. For OPP and OCE contracts, a standard contract is used. We will assure that OLA and the Comptroller approve the standard contract and that any modifications to the standard contract are approved by the appropriate official.

Recommendation 8: LSC will review the additional four contract provisions identified and will add those found to be relevant.

Recommendation 9: The Administrative Manual requires that the contract approval form be used for all contracts. The revised Administrative Manual provision for OPP and OCE consultant contracts will address this issue.

Recommendation 10: The Comptroller's Office has instituted a new procedure for purchase orders. That process includes a provision that contracts be reviewed for proper execution prior to purchase orders being written.

Recommendation 11: We will specify in the Administrative Manual which consultant contract records must be maintained and where they are to be maintained.

Recommendation 12: LSC will provide training to all employees on the revised Administrative Manual.

Recommendation 13: We will adopt a reporting requirement for consultant contracts that includes a Comptroller certification and notice to the President of the Corporation.