

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

**RESULTS OF RECIPIENT AUDIT REPORTS
FOR THE YEAR ENDED DECEMBER 31, 1996**

Final Report No. AU97-002

July 1997

July 30, 1997

**TO THE BOARD OF DIRECTORS
OF
THE LEGAL SERVICES CORPORATION**

As you know, the Corporation's fiscal year 1996 appropriations statute (PL 104-134) directed that annual financial statement audits be used as the primary means for checking grantee compliance with applicable laws and regulations. The law became effective with audits performed after January 1, 1996, and reports of those audits for the year ended December 31, 1996 were due to the Office of Inspector General (OIG) by April 30, 1997. This report presents the results of the first round of audits performed in accordance with that statute.

Independent Public Accountants reported 169 findings related to 39 grantees in the 216 audit reports received in this cycle. Of those, 71 findings were deemed significant and reported to LSC management for follow up and resolution in accordance with OMB Circular A-50. The remainder involved minor omissions or discrepancies as described on the last page of this report.

Only 3 of the 71 significant findings reported grantee noncompliance with prohibitions and restrictions on the provision of legal services. In one, a class action case was not divested until 13 days after the statutory deadline; in another, a motion to withdraw from representation of a group of aliens was opposed by the state and still pending at the time of the audit. In a third finding, a grantee employee had used an organizational computer on one occasion during the employee's campaign for state office.

Missing documents, such as required client statements of fact, citizenship attestations, and retainer agreements, were reported in 22 instances. All were considered significant because missing documentation could conceal noncompliance or other reportable conditions. The next most frequently reported finding (11 instances) concerned timekeeping systems and procedures, which were considered significant because accurate timekeeping records are absolutely essential to ensuring that there are no violations of prohibitions and restrictions.

This report will be provided to the Corporation's authorization and appropriations committees of Congress, and will be made available to the public not later than August 30, 1997.

Edouard R. Quatrevaux
Inspector General

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AUDIT REQUIREMENTS

Recipients of grants from the Legal Services Corporation (LSC) are responsible for preparing annual financial statements and arranging for audits of those statements by Independent Public Accountants (IPAs). These audits are to be conducted in accordance with Government Auditing Standards promulgated by the Comptroller General of the United States, Office of Management and Budget (OMB) Circular A-133 “Audits of Institutions of Higher Education and Other Non-Profit Institutions,” and the LSC “Audit Guide for Recipients and Auditors.”

Recipients are required to arrange for audit reports to be submitted to the LSC Office of Inspector General (OIG) within 120 days of the recipients’ fiscal year ends. IPAs should follow the requirements of Government Auditing Standards, OMB Circular A-133, and American Institute of Certified Professional Accountants (AICPA) professional standards for guidance on the form and content of reports. Such IPA reports include an opinion on the financial statements, a report on the internal control structure, a report on compliance with laws and regulations, and a management letter, when appropriate.

In addition, IPAs are required to submit a Summary Report Form on Noncompliance with Laws and Regulations, Questioned Costs and Reportable Conditions (SRF). IPAs must submit SRFs via the Internet by completing a form residing on the OIG website. The SRF must be submitted regardless of whether or not there are any audit findings to report. The IPA reports on the SRF any instances of noncompliance, material reportable conditions and additional findings. For reported findings, the IPA provides the findings description and Audit Guide code, the sample size and instances noted, the recipient response, and the amount of any questioned costs.

Under certain circumstances, the recipient is required to submit to the OIG a special report, commonly referred to as a 5-Day letter. When a determination has been made, based on sufficient competent evidential matter, that an instance of noncompliance has occurred, IPAs are to report immediately to the recipient. The report must contain a description of the instances of noncompliance and the circumstances. The recipient is required to submit to the OIG, with a copy to the IPA, a Recipient 5-Day “Special Report” to the OIG on Noncompliance with Laws and Regulations within five business days after issuance of the IPA’s special report to the recipient. If the IPA does not receive a copy, the IPA must submit a copy of the report directly to the OIG within five business days of the recipient’s failure to provide the required copy.

Recipients must submit corrective action plans to the OIG for all recommendations and findings which include material reportable conditions in internal control, material noncompliance with laws and regulations identified in the LSC Compliance Supplement, and questioned costs including those of sub-recipients. Recipients are required to develop corrective action plans describing the corrective action taken or planned in response to the audit findings and recommendations identified by the IPA. If the recipient disagrees with the finding or believes that corrective action is not required, it must provide an explanation and specific reasons. The recipient must submit the corrective action plan to the OIG within 30 days of submission of the audit report. Alternatively, the recipient has the option of incorporating the corrective action plans into the audit reports as part of its response to the auditor's findings and recommendations, but this option does not extend the due date for audit reports.

SCOPE

The scope of this report is grantee audit reports for the calendar year ended December 31, 1996. Of the 219 recipients that have a December 31 year end, 216 audit reports have been received. Three reports from former grantees are delinquent, and LSC management is pursuing the matter. Independent Public Accountants (IPAs) for 39 of the 216 recipients that submitted audit and other required reports reported one or more findings of noncompliance and/or material reportable conditions. All but 8 of the required corrective action plans have been received to date and LSC management is responsible for ensuring their submission after notification by the OIG.

METHODOLOGY

Processing Recipient Audit Reports

The following is a summary of the process carried out by LSC from receipt of the Summary Report Form (SRF) through implementation of corrective action.

The OIG developed an Audit Information Management System (AIMS) to support the audit review team in performing a desk review of the grant recipient audit reports by tracking and collecting the SRF, audit reports, 5-day letters, audit costs, and management letters. In addition, AIMS facilitates an OIG focused review, tracks the status, and documents the resolution and corrective action process of audit findings and recommendations.

Once the SRF is received, OIG staff validates the correctness of the SRF submission before it is accepted for entry into AIMS. The SRF can be accepted, edited or deleted. This approach allows the OIG to avoid redundant data entry by transferring the accepted SRF data into AIMS electronically. After the audit reports are received, OIG staff review each of them for completeness.

Focused Review

Next, the OIG conducts a focused review of audit findings and recommendations for SRF entries which have been accepted and have findings. The OIG auditors can create new findings or

amend existing ones based on the SRF, the 5-Day letter, the audit reports, and the management letter. The auditor reviews the findings and recommendations and determines his or her recommended action, which is either to “invoke A-50” or to “close to inventory.” The LSC grantee audit follow up process incorporates the concepts of OMB Circular A-50 “Audit Follow up,” and hence the use in AIMS of the term “invoke A-50.” The auditor then writes a justification for the recommended action. The recommended action is then approved or revised by OIG audit management.

If the decision is to invoke A-50, OIG audit management refers the audit findings and recommendations to LSC management for follow up action. The referral is made through AIMS by approving the finding for follow up and establishing a project code to track the follow up process through resolution and corrective action.

If the decision is to close to inventory, the findings and recommendations issued to grantees by their IPAs are retained in the AIMS system in an inventory of non-critical findings. These findings are provided to LSC management by the OIG for information only and no follow up action is required. However, under Government Auditing Standards, the IPAs are required to follow up on these findings in the next fiscal year audit. If the IPAs report that these findings are still uncorrected, A-50 will be invoked at that time.

The decision of whether to invoke A-50 or to close to inventory rests on whether or not the finding is significant. A significant finding is one deemed by the OIG to require management’s attention based on quantitative and/or qualitative conditions contained in the finding and, thus, is referred to LSC management. The following types of findings and recommendations by grantee IPAs will be referred to LSC management for follow up: instances of noncompliance with laws and regulations which have a material impact on the LSC program, instances of questioned or unsupported costs, instances of material weaknesses, reportable conditions that taken in whole or in part are indicative of a systemic problem, and uncorrected findings from prior reports.

LSC management has the responsibility for follow up on significant findings found by grantee IPAs and referred by the OIG to ensure that instances of deficiencies and noncompliance are resolved in a timely manner. To facilitate the responsibilities of LSC management and the OIG, recipients are required to submit corrective action plans to the OIG, which forwards them to LSC management when received. If the recipient fails to submit the corrective action plan within 30 days of submission of the audit report to the OIG, the OIG notifies LSC management, which then requires that the recipient do so immediately.

Resolution

Resolution is the point at which LSC management agrees with the grantee’s proposed corrective action plan or accepts the grantee’s disagreement with a reported finding and the OIG concurs in the management decision. If agreement cannot be reached, resolution is reached when the LSC Audit Follow Up Official, designated by the LSC President, issues a decision on the matter.

LSC management reviews each referred finding and recommendation along with the corrective action plan proposed by the grantee to determine if it is satisfactory. If the proposed corrective action is deemed unsatisfactory, LSC management communicates with the grantee to ensure a satisfactory corrective action plan.

LSC management ensures that proposed corrective actions are consistent with law, regulations, and LSC policy. When accepting the grantee's disagreement with a reported finding or recommendation, LSC management ensures that the grantee provides an adequate written justification containing the legal and factual basis for the disagreement. LSC management notifies the OIG of the corrective action agreed upon by LSC management and the grantee, or of LSC management's acceptance of the grantee's disagreement within 30 days of receipt of the referred finding.

The OIG notifies LSC management within 15 days of its concurrence or nonconcurrence. If the OIG concurs, the finding is considered resolved. If the OIG does not concur, the Audit Follow Up Official has 15 days to seek agreement between LSC management and the OIG. If no agreement is reached within the 15 days, the Audit Follow Up Official issues a decision within 7 days, and the finding is considered resolved.

Corrective Action

After resolution has been obtained, LSC management ensures that corrective actions have been taken by the grantee within six months of the date on which resolution is reached. LSC requires the grantee to provide sufficient documentation to ensure that the corrective action has been fully implemented. In addition, the grantee is required to certify in writing that all corrective actions have been implemented. LSC management then notifies the OIG of all completed corrective actions and provides the OIG with copies of the grantee certifications. Upon receipt of the notification of completion, the OIG closes the respective findings and recommendations. IPAs will also verify completion of corrective actions during the next fiscal year audit.

Quality Control Process

The OIG conducts a review of every audit report submitted to ensure adherence to Government Auditing Standards. In addition, on a test basis, the OIG reviews the IPAs' working papers to ensure conformity with applicable auditing standards and LSC Audit Guide and Compliance Supplement requirements.

RESULTS

The grantee audit reports submitted for the year ended December 31, 1996 contained 71 findings which were deemed to be significant and for which A-50 was invoked. Although the categories listed are not mutually exclusive and some findings could be listed in more than one category, the following summary shows each finding in only one category for ease of reference.

Summary of Significant Findings **Grantee Audit Reports for the Year Ended 12/31/96**

| <u>Category</u> | <u>Number of findings</u> |
|--|---------------------------|
| Noncompliance with prohibitions and/or restrictions..... | 3 |
| Missing documents (i.e., client statement of facts, citizenship attestation, retainer agreements)..... | 22 |
| Timekeeping procedures and/or systems are inadequate (whether or not a corrective action plan was submitted) and/or were not followed | 11 |
| Missing files..... | 2 |
| Many instances and/or large percentage of sample are exceptions..... | 5 |
| Questioned costs | 4 |
| Systemic problem..... | 4 |
| Uncorrected prior year finding..... | 2 |
| Policies and procedures not established..... | 1 |
| LSC fund balance was greater than 10% of LSC support requiring a waiver from LSC..... | 5 |
| P.A.I. was less than the required 12.5% requiring a waiver from LSC | 3 |
| Potential fraud (also referred to OIG-Investigations) | 1 |
| Cost Allocation Plan missing or not in accordance with standards and requirements | 1 |
| FDIC insurance limits are exceeded and corrective action is not taken before or during the audit (and/or grantee deliberately persists in the policy)..... | 1 |
| Prohibited payments (i.e., payment of dues to Chamber of Commerce) | 1 |
| Large number/percentage of employees unfamiliar with prohibitions, restrictions, and/or requirements..... | 2 |
| Material internal control weakness over cash receipts and/or disbursements..... | 2 |
| Required report on planned priorities on use of resources missing | 1 |
| Total | 71 |

There were three significant findings for noncompliance with prohibitions and/or restrictions involving three recipients:

- o Class Actions - One class action was not divested until August 13, 1996, 13 days after the statutory deadline. The recipient reported the situation to the LSC Office of Program Evaluation on August 6, 1996.
- o Restrictions on legal assistance to aliens - The IPA advised that a motion was pending in Court for substitute counsel to take over a case concerning housing for a group of 12 aliens. The motion was being opposed by the New York State Department of Social Services at the time of the audit.
- o Prohibited political activity - A computer and printer owned by the recipient were used on one occasion by an employee for political purposes during that employee's campaign for state office.

The largest number of significant findings (22) concerned missing documents, such as client statement of facts, citizenship attestation, and retainer agreements. All cases of missing documents were deemed significant because absence of documentation can obscure instances of noncompliance or other reportable conditions

The second largest category of findings (11) concerns timekeeping systems and procedures which were inadequate or were not followed. All timekeeping findings were deemed significant because accurate and reliable timekeeping is absolutely essential to ensure that there are no violations of prohibitions or restrictions. All timekeeping findings were reported as significant whether or not corrective action plans had been submitted or corrective action had already been taken because the issue is critical to LSC management.

The next largest number of findings (5) that were considered significant were those findings in which a significant percentage of a test sample was found to be an exception. These five findings for four recipients are each described as follows:

- o A client signature was not evident on retainer agreements in 3 of 20 files sampled.
- o A client signature was not evident on retainer agreements in 8 of 75 files sampled.
- o A client signature was not evident on attestations of U.S. citizenship in 13 of 75 files sampled.
- o Asset verification on the client intake forms was not evident in 11 of 60 files sampled.
- o Client intake forms were incomplete in 21 of 81 files sampled.

Five of the findings considered significant were findings that the LSC fund balance was greater than 10% of LSC support, requiring a waiver from LSC. Three of the findings reported as significant were findings that Private Attorney Involvement (P.A.I.) was less than the required 12.5%, also requiring a waiver from LSC.

Four of the findings reported as significant were for questioned costs. The amounts of the questioned costs for four recipients were \$4,630, \$675, \$247, and \$188.

Four findings were considered significant because they were indicative of a systemic problem. These four findings for four recipients are as follows:

- o For one recipient, the asset eligibility standards did not match the LSC standards, and the IPA noted a number of records in which the field for client assets was blank.
- o For one recipient, although the procedure for verification of citizenship was being followed, clients had not been signing their declaration forms. (Corrective action was taken and no cases of ineligibility were noted.)
- o For one recipient, monthly financial reports and budgets were not timely, and management had insufficient financial information to plan and manage operations.
- o For one recipient, revenues and expenses for grants were not being reviewed by the grantee's management, and the IPA considered this lack of review to be a material weakness.

As shown on the chart, there were only one or two instances of each of the remaining types of findings deemed significant.

Findings Not Deemed Significant

In addition to the 71 significant findings summarized in the attached, the grantee audit reports for the year ended December 31, 1996 contained 98 other findings not deemed significant. These findings fall into one or more of the following groups:

- (1) Very few instances and/or small percentage of sample tested of a minor issue, such as incomplete documentation or lack of signature where other procedures were followed and/or other documents were signed by the same client.
- (2) Missing policy and policy adopted during audit and no violation of the subsequently adopted policy.
- (3) Policy and procedures in place and operating effectively and documented in files, but missing a summary list or schedule .
- (4) Failure to take a physical inventory of equipment, but adopted corrective action plan during audit.
- (5) Bank balance exceeded FDIC insurance limits and corrective action was taken before or during the audit.
- (6) Minor omissions or discrepancies, i.e., document obtained and signed but undated.
- (7) Nonmaterial lack of segregation of duties.
- (8) Minor or infrequent internal control inadequacy, i.e., missing a supervisory review, procedure completed shortly after deadline, outstanding checks not voided after one year, etc.
- (9) Small number of employees unfamiliar with some requirements, and corrective action taken during the audit.
- (10) Inadequate documentation of peripheral matters, i.e., procurement bids.