Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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March 21, 2013

Lillian O. Johnson
Executive Director
Community Legal Services, Inc.
305 South 2nd Avenue
P.O. Box 21538
Phoenix, AZ 85036-1538

Dear Ms. Johnson:

Enclosed is the Office of Inspector General's (OIG) final report of our audit on Selected Internal Controls at Community Legal Services. The OIG considers your proposed actions as responsive to the four findings and recommendations. However, the recommendations will remain open until OIG receives written notification that all agreed-upon actions have been implemented.

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

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman
President

Lynn Jennings
Vice President for Grants Management

LSC
America's Partner For Equal Justice

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

COMMUNITY LEGAL SERVICES, INC.

RNO 703030

Report No. AU 13-03

March 2013

www.oig.lsc.gov

INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls at Community Legal Services Inc., (CLS or grantee), Phoenix, Arizona, related to specific grantee operations and oversight. Audit work was conducted at the grantee's main office in Phoenix, Arizona and at LSC headquarters in Washington, DC. The on-site fieldwork was conducted from June 25, 2012 to June 29, 2012. Documents reviewed pertained to the period January 1, 2011 through May 31, 2012.

In accordance with the Legal Services Corporation Accounting Guide for LSC Recipients (2010 Edition) (Accounting Guide), Chapter 3, an LSC grantee "...is required to establish and maintain adequate accounting records and internal control procedures." The Accounting Guide defines internal control as follows:

> [T]he process put in place, managed and maintained by the recipient's board of directors and management, which is designed to provide reasonable assurance of achieving the following objectives:
>
> 1. safeguarding of assets against unauthorized use or disposition;
> 2. ensuring reliability of financial information and reporting; and
> 3. compliance with regulations and laws that have a direct and material effect on the program.

Chapter 3 of the Accounting Guide further provides that each grantee "must rely upon its own system of internal accounting controls and procedures to address concerns" such as defalcations and meeting the complete financial information needs of its management.

BACKGROUND

According to its website, CLS is a not-for-profit Arizona law firm incorporated in 1952, which provides critically needed civil legal help to more than 50,000 persons annually – through legal work, community outreach and education presentations and activities, the development and distribution of educational materials, and through community based partnerships. CLS provides legal advice, assistance and advocacy to low-income Arizonans in certain civil legal matters throughout its service areas.

The grantee's service area is made up of five counties in central and western Arizona. It is a mixed urban/rural area. Maricopa County is primarily urban and includes four of the five largest cities in the state. Yavapai, Mohave, Yuma and La Paz Counties are primarily rural. The grantee was awarded $4,463,532 and $3,809,186 of LSC funds respectively for calendar years 2011 and 2012.

OBJECTIVE

The overall audit objective was to assess the adequacy of selected internal controls in place at CLS. Those controls related to specific grantee operations and oversight, including program expenditures and fiscal accountability. Specifically, the audit evaluated selected financial and administrative areas and tested the related controls to ensure that costs were adequately supported and allowed under the LSC Act and LSC regulations.

SCOPE AND METHODOLOGY

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

- Cash disbursements
- Contracting
- Credit cards
- Derivative income
- Internal management reporting and budgeting
- Property and equipment

Controls over salary advances were reviewed, but not tested because no salary advances were awarded during our period of review. Controls over cost allocation were discussed with grantee management.

To obtain an understanding of the internal controls over these areas, the grantee's policies and procedures were reviewed, including any manuals, guidelines, memoranda, and directives setting forth current grantee policies. Grantee officials were interviewed to obtain an understanding of the internal control framework, and staff were interviewed as to their knowledge and understanding of the processes in place. We assessed the reliability of computer generated data provided by the grantee by reviewing source documentation for the entries selected for review. We determined that the data were sufficiently reliable for the purposes of this report.

To review and evaluate internal controls, the grantee's internal control system and processes were compared to the guidelines in the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the Accounting Guide.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample represented 3.5 percent of the approximately $1.7 million disbursed for expenses other than payroll during the period January 1, 2011 to May 31, 2012 and consisted of 65 transactions totaling $60,946.

To assess the appropriateness of grantee expenditures, we reviewed invoices, vendor lists, and traced expenditures to the general ledger. The appropriateness of grantee expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance.

To evaluate and test internal controls over contracting, credit card use, derivative income, internal management reporting and budgeting, and property inventory, we interviewed appropriate program personnel, examined related policies and procedures, and selected specific transactions to review for adequacy. To gain an understanding of the cost allocation process, we discussed the process with grantee management and requested, for review, the grantee's written cost allocation policies and procedures as required by the *Fundamental Criteria*.

This review was limited in scope and not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

The on-site fieldwork was conducted at the grantee's central administrative office in Phoenix, Arizona from June 25, 2012 to June 29, 2012. Documents reviewed pertained to the period January 1, 2011 to May 31, 2012. The remainder of our work was conducted at LSC headquarters in Washington, DC.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that the audit be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The OIG believes the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

OVERALL EVALUATION

Internal controls reviewed and tested at CLS were adequate as the controls related to specific grantee operations and oversight. Controls over program expenditures and fiscal accountability were generally adequate. However, we were not provided with supporting documentation for four disbursements and four other disbursements were not properly approved. Moreover, some controls and practices need to be formalized and documented.

Disbursements tested were, for the most part, adequately supported and allowable. However, the OIG discovered four disbursements, totaling $1,412, that were not properly approved as required in the grantee's accounting manual.[1] In addition, the grantee did not provide support for four other disbursements totaling $426. The OIG found that the grantee's current practices for cost allocation and contracting were not documented in the grantee's accounting manual.

Our evaluation and testing of controls in the areas of credit card purchases, internal budgeting and management reporting, derivative income, and property and equipment revealed that internal controls in those areas were adequate and operating as intended. Although no salary advances were made during the period reviewed, the controls appeared to be adequately designed.

AUDIT FINDINGS

DISBURSEMENTS

In general, most disbursements were properly approved and adequately documented. Written policies and procedures were in compliance with LSC's *Fundamental Criteria*. However, these procedures were not followed in some instances. In four cases, disbursements were not properly approved and in four other cases, the grantee could not provide the supporting documentation. Obtaining proper approval for disbursements and maintaining adequate supporting documentation helps ensure that funds are only used for authorized purposes.

Disbursements Not Properly Approved

Management's approval was not documented for four disbursements. The four disbursements consisted of two disbursements for restaurant meals and two for petty cash purchases for a total of $1,412. Because two of the disbursements were over $250, the grantee's accounting manual required the purchases be approved by the Executive Director. The other two disbursements were for petty cash amounts greater than $20 and as result required approval by the Executive Director, Finance Manager or Manager. Because grantee management was able to provide supporting documentation subsequent to receiving the draft report, the OIG is not questioning the $1,412 associated with these disbursements (see footnote 1).

Disbursements Not Supported

The OIG was not provided supporting documentation for four disbursements totaling $426 that were charged to LSC funds. Those disbursements were for an airport shuttle, two restaurant charges and a purchase from Staples. Without supporting

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[1] Subsequent to the draft report, grantee management provided additional documentation that demonstrated the disbursements had been properly approved as required by the grantee's accounting manual. We have reviewed the additional documentation and will not question the costs associated with the lack of proper approval for the $1,412. References to the questioned costs contained in other parts of the draft report have also been removed from the final report.

documentation, the OIG was unable to determine whether these expenses were reasonable and necessary for the performance of the grant.

Management officials could not provide an explanation as to why proper approvals were not obtained or why supporting documentation could not be found.

Recommendation 1. The Executive Director should enforce the grantee's written policies and procedures that require disbursements to be properly approved and fully supported.

DOCUMENTING POLICIES AND PROCEDURES

The grantee's practices in the areas of contracting and cost allocation were not documented.

Contracting

The policy and procedures involved in soliciting, evaluating and awarding individual contracts were not documented, and contracts and the related supporting documents were not centrally filed. However, the grantee did have practices in place that were in conformity with LSC's *Fundamental Criteria*. We reviewed three contracts:

1. Keyed Communications -- $78,547.59
2. Arizona's Children Association -- $11,473.00
3. Kimberly Banach -- $4,942.50

Our review of documentation for two contracts awarded within the past two years and one non-consulting contract currently up for award showed that the grantee:

- Identifies its needs,
- Identifies multiple suppliers where practical,
- Discusses its needs with prospective contractors so responsive bids are provided,
- Sets evaluation standards, and
- Obtains LSC advance approval when required.

The grantee's Director of Finance and Information Systems, who was significantly involved in the non-consulting contract, stated that he follows the guidance in LSC's Property Acquisition and Management Manual (PAMM), with respect to contracting, but did not find it necessary to duplicate those procedures by repeating them in the grantee's accounting manual. PAMM, Section 9 *Recipient Policies and Procedures* states that recipients shall develop written policies and procedures which implement, at a minimum, the requirements of Sections 3 and 4 herein. Sections 3 and 4 relate to the acquisition of both real and personal property.

In addition to not documenting its contracting policy and procedures, the grantee has no requirement to maintain contracting documentation in a central file. Some of the contracting documentation was in the contract file, but other information was maintained in the personal files of the Director of Finance and Information Systems and not in a central location accessible by others who may have a need to review or work with the documents.

The *Fundamental Criteria* in LSC's Accounting Guide provides that the process used for each contract action should be fully documented and the documentation maintained in a central file. Paragraph 3-5.16 of LSC's Accounting Guide requires each step in the contracting process to be fully documented to ensure that the individual contracting steps have been properly followed. It also requires that all contract documents relating to a particular procurement be kept with that procurement. This can be achieved by filing contracts and supporting documentation in a central location which will provide better document control and aid in supporting the transparency of the process.

By documenting its contracting policy and procedures, the grantee better ensures that staff members understand the policy and consistently apply the procedures, that the process for selecting vendors and consultants is fair, and that the entire process is transparent.

Centrally filed contracts and supporting documents aid in the control over the contracting process by providing an easy determination as to whether pertinent processes have been completed or whether approvals for deviations from accepted procedures were authorized.

Cost Allocation

The grantee's cost allocation system was not documented in the grantee's accounting manual. Paragraph 3-5.9(c) of LSC's Accounting Guide states that the cost allocation formula should be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO and others, to easily understand, follow, and test the formula. The cost allocation system requires various steps in order to properly apply the percentages used to allocate indirect costs. Therefore, if the person most knowledgeable of the allocation system should leave, it would be very difficult, and take an extended period of time, for a new person to identify all the steps required to operate the system and ensure that the system is making allocations as designed. Having a fully documented allocation system improves internal controls by helping ensure that the system is operated properly, that funds are fairly and accurately charged to the appropriate funding sources, and that the organization is protected should a key staff member leave.

Recommendations

The Executive Director should:

Recommendation 2: Formally document the grantee's policy and procedures related to contracting for personal and real property, and for consulting contracts.

Recommendation 3: Create a centralized contract filing system whereby each contract file relates to a specific contract and contains all pertinent documents related to the solicitation, receipt and evaluation of bids, and the award of that contract.

Recommendation 4: Ensure that the cost allocation process is fully documented in CLS' accounting manual.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management accepted and has agreed to implement all four of the recommendations as stated. Grantee management stated they believed they were generally in compliance with the procedures and internal controls over disbursements, including obtaining advance approval before making expenditures. Grantee management acknowledged that written policies pertaining to the disbursement process should be updated to reflect the efforts made in automating the administrative procedures. Grantee management also stated, while its accounting manual will be revised to reflect the automated processes, changes have already been made to ensure that the Executive Director and/or Finance and Information Systems Director signs each individual petty cash voucher in addition to the check request denoting approval of the expenditure.

In regard to unsupported disbursements, grantee management indicated that efforts to locate the support documentation were ongoing and that LSC will be reimbursed the $426 from unrestricted non-LSC funds.

The grantee included 51 pages of additional documentation for our analysis with management's comments. Because of the financial nature of the documents and the number of pages involved, the OIG has included only the text of the grantee's comments at Appendix I.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

Grantee management comments were responsive to all findings and recommendations in this report. The OIG considers Recommendations 1, 2, 3 and 4 as open until such time as written notification is received by the OIG that all agreed to actions have been taken and implemented by the grantee.

The OIG considers the additional documentation provided with grantee management's response as adequate to support the expenditures identified as unapproved in the draft report. Therefore, the OIG no longer considers the value of these expenditures to be a questioned cost. In addition, the OIG will not refer the $426 in unsupported costs to LSC management for further action because the grantee will reimburse LSC for that amount and because of the low dollar value involved.

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Maricopa County - Central Office
Yavapai County - Prescott Office
Yuma/La Paz Counties - Yuma Office

February 8, 2013

Ronald D. Merryman
Assistant Inspector General for Audit
Office of Inspector General
Legal Services Corporation
3333 K Street, NW, 3rd Floor
Washington, DC 20007-3558

RE: Draft Report on Selected Internal Controls
Community Legal Services
RNO 703030

Dear Mr. Merryman:

This letter is in response to the Office of Inspector General Legal Service Corporation's letter dated December 4, 2012, regarding Community Legal Services' ("CLS") Draft Report on Selected Internal Controls. CLS' responses are enclosed.

If you have any questions or need additional information, please contact me at Ljohnson@clsaz.org (602)-258-3434, ext. 2280 or Otis Perkins, Finance & Information System Director, at operkins@clsaz.org or (602) 258-3434, extension 2170.

Sincerely,

Lillian O. Johnson

Lillian O. Johnson
Executive Director

LOJ/eg
Enclosures
cc: Anthony Ramirez

AUDIT FINDINGS

DISBURSEMENTS NOT PROPERLY APPROVED

Auditor's Finding: Management's approval was not documented for four disbursements. The four disbursements consisted of two disbursements for restaurant meals and two for petty cash purchases for a total of $1,412. Because two of the disbursements were over $250, the grantee's accounting manual required the purchases be approved by the Executive Director. The other two disbursements were for petty cash amounts greater than $20 and as a result required approval by the Executive Director, Finance Manager or Manager.

Management Response: CLS is in the process of automating its administrative procedures to save time, money and other resources. As a result, administration prepares a check request to generate the check, make sure it is made out to the appropriate person(s) or company and indicates the purpose (description/memo). Please note that all disbursements have the approval of the Executive Director/designee. While we acknowledge that our written policy should be updated (and we plan to do that) to reflect our automation, we do believe that we are generally in compliance with our procedures and internal controls are in place to ensure that proper review and approval is obtained before expenditures are made.

Attached is the documentation for the four expenditures described as unapproved.

Restaurant Meals

Please note that the two disbursements for restaurant meals were payment for catered meals for our regularly scheduled board meetings, held in CLS' training room in downtown Phoenix. Attached are the check requests and supporting documentation, along with a copy of the board minutes, for each of those meetings.

Petty Cash Purchases

Lilly Paniagua is CLS' Human Resources Administrator and she administers the petty cash for the Central Phoenix Office under the supervision of both the Executive Director and the Finance & Information System Director. While there are petty cash vouchers which are not individually signed by either the Executive Director or the Finance & Information System Director, the check request generated by Accounts Payable is reviewed and approved by both the Finance & Information System Director and the Executive Director. While we plan to revise the accounting manual to make it consistent with the automated process, in the meantime, we have changed our practice to ensure that the Executive Director and/or the Finance & Information System Director signs each individual petty cash voucher in addition to the check request approval.

DISBURSEMENTS NOT SUPPORTED

Auditor's Finding: The OIG was not provided supporting documentation for four disbursements totaling $426 that were charged to LSC funds. Those disbursements were for an airport shuttle, two restaurant charges and a purchase from Staples. Without supporting documentation, the OIG was unable to determine whether these expenses were reasonable and necessary for the performance of the grant.

Management officials could not provide an explanation as to why proper approvals were not obtained or why supporting documentation could not be found. Because the eight disbursements identified are not properly *supported within the meaning of 45 CFR § 1630.2, the OIG is questioning $1,838, the total value of the eight disbursements. The OIG will refer the questioned costs to LSC management for review and action.*

Management Response: CLS is still in the process of securing documentation for the charges to the CLS credit cards for the two restaurant charges of $47.68 and $91.15 (incurred for staff development); a purchase from Staples for $254.04 (incurred for office supplies); and an airport shuttle charge of $33.00 (incurred for training/travel) totaling $426 that were charged to LSC funds. Two of the managing attorneys responsible for the charges have since retired or obtained other employment. We will continue to investigate and make efforts to secure the supporting documentation. In the meantime, we will reimburse LSC the $426 from unrestricted non-LSC funds.

RECOMMENDATIONS

RECOMMENDATION 1

The Executive Director should enforce the grantee's written policies and procedures that require disbursements to be properly approved and fully supported.

Management Response: Management accepts and will implement the Auditor's recommendation as stated.

RECOMMENDATION 2

Formally document the grantee's policy and procedures related to contracting for personal and real property, and for consulting contracts.

Management Response: Management accepts and will implement the Auditor's recommendation as stated.

RECOMMENDATION 3

Create a centralized contract filing system whereby each contract file relates to a specific contract and contains all pertinent documents related to the solicitation, receipt and evaluation of bids, and the award of that contract.

Management Response: Management accepts and will implement the Auditor's recommendation as stated.

RECOMMENDATION 4

Ensure that the cost allocation process is fully documented in CLS' accounting manual.

Management Response: Management accepts and will implement the Auditor's recommendation as stated.

COMMUNITY LEGAL SERVICES

Date: February 8, 2013

By: Lillian O. Johnson

Lillian O. Johnson
Executive Director

Attachments