LSC

Legal Services Corporation
Office of Inspector General

Inspector General
Jeffrey E. Schanz

August 10, 2009

Mr. Errol A. Summerlin
Chief Executive Officer
Legal Aid of NorthWest Texas
600 East Weatherford Street
Fort Worth, Texas 76102

Dear Mr. Summerlin:

Enclosed is the Office of Inspector General's (OIG's) final report on the audit of Selected Internal Controls at Legal Aid of Northwest Texas. In your comments, you disagreed with the finding on construction costs and Recommendation 1. In addition, your comments were partially responsive to Recommendation 3, and not responsive to Recommendations 4 and 6. You also disagreed with the questioned costs associated with the findings related to Recommendations 1 and 3. Therefore, Recommendations 1, 3, 4 and 6, and the associated questioned costs will be referred to LSC management for action.

Your comments were responsive to Recommendations 2 and 5. Both of these recommendations are considered open. Recommendation 2 will remain open until all actions necessary to establish LSC's reversionary interest in the new building are complete and evidence of such is forwarded to the OIG. Recommendation 5 will remain open until the OIG receives and reviews copies of the recently transcribed Board and committee minutes from 2008.

I want to thank you and your staff for the cooperation and assistance you provided us.

Sincerely,

Jeffrey E. Schanz
Inspector General

cc: Karen Sarjeant
Legal Services Corporation
Vice President for Programs and Compliance

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LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

LEGAL AID OF NORTHWEST TEXAS

RNO 744050

Report No. AU09-06

August 2009

www.oig.lsc.gov

EXECUTIVE SUMMARY

Audit Process: The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Legal Aid of NorthWest Texas (grantee) related to specific grantee operations and oversight. The audit was expanded to review two specific issues relating to the construction of the grantee's new building and a consulting contract entered into by the grantee's Board of Directors. Audit work was conducted at the grantee's main office in Fort Worth, TX and at LSC headquarters in Washington, DC. The on-site fieldwork was conducted from February 23 through February 27, 2009.

Results in Brief: The grantee incurred costs of over $188,000 to pay for decorative stone imported from Italy that was used in the construction of its new headquarters building. Three payments using LSC funds to a consultant totaling over $41,000 were not fully supported. These costs are being questioned by the OIG and are referred to LSC for action.

Internal controls need to be strengthened in some areas. The grantee's Accounting Manual needs to be updated to ensure that the requirements of the Accounting Guide for LSC Recipients are included and adequately addressed. These requirements include policies and procedures on internal management reporting and budgeting, and contracting for consultants.

While members of the Board of Directors were receiving required financial information, documentation provided to the members did not include sufficient explanatory material that would help interpret the data received. As the grantee could not provide written minutes of all the Board meetings and Audit Committee meetings for 2008, we could not determine what Board members were told during the meetings about the data received.

The OIG found that except for the payments of over $41,000 to one consultant, other disbursements tested were adequately supported, allowable, and appeared to be properly allocated to LSC funds.

Recommendations: The OIG is making the following recommendations and questioning costs totaling over $229,000. The OIG recommends that the grantee ensure that no LSC funds are used for the decorative stone; establish LSC's interest in the new building; update the Accounting Manual to include policies and procedures for internal reporting and budgeting as well as for contracting with consultants; and adequately document Board of Director meetings.

Grantee's Response: The grantee disagreed with the finding and recommendation related to the imported Italian stone and stated that the OIG's questioning of the "…reasonableness of the cost lacks foundation and is unwarranted." The grantee is working with LSC to establish LSC's reversionary interest in the building. A new policy on consulting contracts was developed.

However, the grantee disagreed that the expenditures for the consulting contracts identified in the finding were not adequately supported and disagreed with the associated questioned cost. The grantee has instituted a "narrative" explanation that is included with monthly financial statements and budget narratives will also be included in the adoption of budgets. The grantee stated minutes have been transcribed for all board meetings in 2007 and 2008 and that minutes for only three meetings were not available during the OIG's visit. Finally, the grantee, rather than developing and updating the program's Accounting Manual, indicated only that the Accounting Manual will be reviewed and updated as necessary.

OIG's Evaluation of Grantee's Response: The grantee's comments are mostly nonresponsive to the issues raised in the report. The grantee provided no detailed analysis or any cost information justifying the cost of imported Italian stone. While the grantee provided a new written policy on consulting contracts, the policy was not sufficiently detailed. The grantee did not provide any additional documentation to support the billings of the consulting contracts identified in the finding. The grantee stated that a narrative explanation is to be included with monthly financial statements. There is no indication that this process has been formalized in writing and included in the Accounting Manual. The grantee did not develop a revised and updated Accounting Manual. These issues, along with questioned costs of $188,522 for the imported Italian stone and $41,195 for inadequately supported contract expenditures will be forwarded to LSC management for action.

The grantee is working with LSC to establish LSC's reversionary interest in the new building. The grantee has also completed the transcription of minutes for all meetings held in 2008. These two recommendations will remain open until LSC's reversionary interest is established and the OIG has received and reviewed the final three sets of meeting minutes that were recently transcribed.

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INTRODUCTION

In accordance with the Legal Services Corporation (LSC) Accounting Guide for LSC Recipients (August 1997) (Accounting Guide), an LSC grantee is required to establish and maintain adequate accounting records and internal control procedures. The Accounting Guide, Chapter 3, defines internal control as the process put in place by the grantee designed to provide reasonable assurance of achieving the following objectives:

- safeguarding of assets against unauthorized use or disposition;
- reliability of financial information and reporting; and
- compliance with regulations and laws that have a direct and material effect on the program.

The Accounting Guide further provides that each grantee must rely upon its system of internal accounting controls and procedures to adequately address concerns arising from such issues as defalcations and to meet the complete financial information needs of its management.

BACKGROUND

During 2008, Legal Aid of Northwest Texas experienced a severe financial crisis. The crisis was partially related to the financing for the demolition of an old office building and construction of a new office building at the same site. This financial crisis resulted in personnel reductions and other cost saving measures that may have impacted the level of service the grantee could provide. After being informed of the severity of the financial crisis, the grantee's Board of Directors contracted with a firm to conduct a detailed study of the problem and to develop solutions.

OBJECTIVE

The overall audit objective was to assess the adequacy of selected internal controls in place at Legal Aid of NorthWest Texas as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability, and compliance with selected LSC regulations. Specifically, the audit evaluated selected financial areas and the related controls as they existed subsequent to the fiscal crisis and the resulting intervention of the grantee's funding sources. In addition, the audit examined selected regulatory policies and grantee processes to assess whether controls were operating in a manner expected to ensure compliance with the LSC Act and selected LSC regulations. Finally, as a result of discussions with grantee management during the course of the audit, the audit was expanded to review specific issues relating to the construction of the grantee's new building and a consultant under contract with the grantee's Board of Directors.

SCOPE AND METHODOLOGY

In accomplishing the objective, the OIG reviewed controls over disbursements, internal management reporting and budgeting, selected LSC regulations, and employee benefits and reimbursements. To obtain an understanding of the internal controls over these areas, grantee policies and procedures, including any manuals, guidelines, memoranda, and directives setting forth current grantee practices were reviewed. Grantee officials and staff were interviewed to obtain an understanding of the internal control framework and their knowledge and understanding of the processes in place. The grantee's independent public accountant was also interviewed. Computer generated data provided by the grantee were relied on to determine whether entries recorded in computer systems matched the information contained on the source documents. However, the general or application controls over the computer system were not tested.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements were reviewed from a judgmentally selected sample of employee and vendor files. The sample represented 43% of the over $3.6 million the grantee disbursed during fiscal year 2008 and consisted of 508 transactions totaling approximately $1.5 million. To assess the appropriateness of grantee expenditures, invoices, vendor lists, and general ledger details were reviewed. The appropriateness of grantee expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance.

In the OIG's review of internal controls over internal management reporting and budgeting, the grantee's system and processes were compared to those detailed in the *Fundamental Criteria of an Accounting and Financial Reporting System* (*Fundamental Criteria*) contained in the Accounting Guide for LSC Recipients.

To review internal controls over compliance with specific LSC regulations, (45 CFR Parts 1610, 1612, and 1617) we examined written compliance policies and procedures, including applicable LSC mandated recordkeeping requirements, to determine if the controls were designed in a manner to ensure compliance with the provisions of the respective LSC regulation.

To assess internal controls over employee benefits and reimbursements, the Collective Bargaining Agreement and written personnel policies and practices were examined. Also, a judgmentally selected sample of employee reimbursements was reviewed as part of the disbursements testing.

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

On-site fieldwork was conducted from February 23 through February 27, 2009. Documents reviewed primarily pertained to the period January 1, 2008 through February 20, 2009, but also included selected documents from 2006 and 2007. Audit work was conducted at the grantee's main office in Fort Worth, TX and 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 evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

OVERALL EVALUATION

Selected internal controls reviewed at Legal Aid of Northwest Texas were generally adequate as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability, and compliance with LSC regulations, except as noted. Controls were operating in a manner expected to ensure compliance with the LSC Act and selected LSC regulations. Nevertheless, internal controls need to be strengthened.

Two significant issues relating to the construction of the grantee's new headquarters building in Fort Worth came to our attention. The grantee incurred costs of over $188,000 to pay for decorative stone imported from Italy that was used in the construction of its new headquarters building. In addition, at the time of the audit the grantee had not yet established LSC's reversionary interest in its new building.

Grantee disbursements tested were adequately supported, allowable, and appeared to be properly allocated to LSC with one notable exception. Sufficient documentation was not on file to support payments made to a consultant under contract with the grantee's Board of Directors during 2008.

The grantee's explanation of the current practices involving internal management reporting and budgeting appears to be in accordance with the *Fundamental Criteria* contained in the Accounting Guide for LSC Recipients. However, systems and processes need to be improved and strengthened, most specifically the implementation of written policies and procedures and adequate documentation of board oversight.

In addition, the grantee needs to update the organization's Accounting Manual to ensure that requirements of the Accounting Guide for LSC Recipients are included and adequately addressed. These requirements include written policies and procedures governing internal management reporting and budgeting and consulting contracting.

Internal controls over compliance with specific LSC regulations, 45 CFR Parts 1612 and 1617 were adequate. Written compliance policies and procedures, including applicable recordkeeping requirements, complied with the respective LSC regulation. However, with regard to 45 CFR Section 1610.8 and submission of the Certification of Program Integrity, the Director of Administration stated that contrary to LSC requirements, the required written report to the Board of Directors had not been previously provided and that only oral reports had been presented.

Finally, the OIG is referring a total of $229,717 in questioned costs to LSC management for action in accordance with 45 CFR § 1630.7. The OIG is questioning specific construction costs and payments to one contractor for which the supporting documentation was not adequate.

AUDIT FINDINGS

BUILDING ISSUES

During the course of the audit, the following issues associated with the construction of the new building came to the OIG's attention.

- Construction Costs. Approximately 5% ($188,522) of the total building construction cost was used for decorative stone imported from Italy. At the entrance conference, the Director of Administration disclosed to the OIG that stone from Italy was used in the construction, stating that approximately $200,000 was spent on stone from Italy for the entryway. A review of invoices and payment documentation revealed that the cost of the stone and related installation amounted to $188,522. The stone was used at the entrance of the building (three stories high) both inside and outside of the building. Under LSC regulation 45 C.F.R. § 1630.3(b) costs may be questioned if they are not reasonable and necessary for the performance of the grant:

  > A cost is reasonable if [among other factors] in its nature or amount, it does not exceed that which would be incurred by a prudent person under the same or similar circumstances prevailing at the time the decision was made to incur the cost.

Due to the cost of the stone and because it appears to be only decorative in nature we question whether any of the cost for the stone is a reasonable and necessary use of LSC funds pursuant to LSC regulation 45 CFR § 1630.3.

Board minutes provided to the OIG revealed that grantee Board members were aware of the purchase of the stone. In the minutes of the Fort Worth Building Committee Meeting conducted on June 17, 2008, the chairman of the committee asked if the stone that was being shipped from Italy had arrived. However, nothing came to the OIG's attention in the Board minutes or in the grantee's vendor files that explained the rationale for the expenditure. The OIG notes that making large expenditures for decorative items may result in fewer funds being available to provide legal services to clients.

The cost of construction for the new building has been paid for with funds from two sources, funds on hand and proceeds from a loan with a financial institution that the grantee plans to repay in large part with LSC funds. Since some if not most of the funds used to purchase the building and pay off the loan were or will be LSC funds, the OIG is questioning the entire amount of $188,522 spent on the stone and will refer this issue to LSC management for action in accordance with 45 CFR § 1630.7.

Recommendation 1. The Chief Executive Officer should ensure that the costs related to the stone are not charged to LSC funds including any LSC funds used as a down payment for the building and any principal and interest payments associated with the building loan repayment. A system of recordkeeping should also be developed to support that no LSC funds were used to pay for the stone.

Grantee Comments. The grantee disagreed with the finding and recommendation and stated their belief that "...the conclusion made by the Inspector General to question the reasonableness of the cost lacks foundation and is unwarranted." The grantee provided a history of the project and a letter from the project manager providing information on the consideration given to the selection of the material used. The grantee based the justification for the stone on the extensive amount of time invested in the project, the need to meet the new Fort Worth Urban Design Standards, savings realized over mortgage payments, and the expert advice received. The full text of grantee's comments can be found at Appendix I.

OIG Evaluation of Grantee Comments.

Grantee comments do not change the OIG's recommendation that the grantee develop a system of recordkeeping to document that no LSC funds are used to pay for the stone. The grantee provided no detailed information to support the cost of the stone as a reasonable and necessary expenditure. Other than general comments about the color of other stone options, grantee comments provided no information on the cost of the other options or if options other than stone were even considered for the building.

Even though expert advice was obtained, the ultimate decision rests with the grantee. The expert's recommendation may not be based on all the factors that the grantee must consider before reaching a decision, including among others, the impact on service to the client community, the best use of the funds provided, whose money is being spent, and how the action will be perceived by funding sources and others. The files provided for review to the OIG team during the on-site visit as well as the information contained in the grantee comments do not provide a detailed analysis of the building material options considered at the time. The letter dated July 15, 2009 from the architecture firm and provided as part of the grantee's comments listed options that were considered but included no cost figures. The reasons provided as to why options were rejected appeared aesthetic in nature. The grantee provided no specific information as to whether the options rejected were less expensive than the one selected or if other less expensive options were considered and if so, whether the difference in cost was justified by more than aesthetic appeal.

The OIG questions the reasonableness and necessity to spend $188,522 on a stone wall. Grantee comments do not provide any specific information on cost of alternatives that were considered or if there were other viable alternatives that were less expensive than the stone wall. As a result, fewer LSC dollars may be available to provide direct services to those in need. The OIG is referring this disagreement and questioned cost to LSC management for action and resolution.

- <u>LSC's Reversionary Interest</u>. The grantee had not updated LSC's interest in the newly constructed building. According to the letter from LSC's Office of Compliance and Enforcement (OCE) approving the construction of the new building, the grantee was to enter into a new property agreement with LSC to reflect LSC's interest in the new building. A footnote to the approval letter indicated that LSC had a property agreement with West Texas Legal Services (the predecessor of the grantee and now out of existence) on the old building that was still valid with the grantee. Grantee personnel stated that a reversionary interest was supposed to be established but did not know if in fact it had been. During the audit, the grantee determined that action had not been taken to establish LSC's interest in the building. The grantee did indicate that action would be taken to establish such an interest now that the construction was complete. The Property Acquisition and Management Manual (PAMM), Section 4(e) requires that LSC and the grantee enter into a written LSC property agreement *at the time LSC approves the grantee's use of funds to acquire real property*. Since the grantee management official who was involved with the approval process was no longer with the grantee, we could not determine why LSC's interest had not been updated at the time of approval. However, the Director of Administration stated that actions were being taken to establish LSC's interest in the property. The interests of LSC are not properly protected unless formal agreements are entered into and properly recorded.

Recommendation 2. The Chief Executive Officer should ensure that all actions are completed to document and record LSC's property interests in the new building as required by PAMM Section 4 (e).

Grantee Comments.

In response to the OIG's recommendation, the grantee stated as follows:

> *The LSC's property interests are protected. West Texas Legal Services purchased the original building with the approval of the LSC and entered into a property agreement. The property agreement reflects the interest of the LSC in the real property records using its legal description. West Texas Legal Services was the surviving corporation in the merger with Legal Services of North Texas. The name change did not affect the validity of the instrument. This was the conclusion reached by both the LSC and LANWT. Nevertheless, LANWT is merely waiting for the LSC to provide a revised property agreement to execute and file with the deed. We will do so upon receipt of the instrument, which is routinely prepared by the LSC, not the grantee.*

OIG Evaluation of Grantee Comments.

Grantee comments are responsive. However, the recommendation will remain open until LANWT executes the property agreement with LSC and files the executed agreement with the deed records.

CONSULTING CONTRACTS

Payments to one contractor were not fully supported. The grantee's Board of Directors contracted with a consultant in 2008 to perform an initial assessment of the critical issues the grantee faced with respect to its cash constraints. The contract was signed by the Chairman of the Board of Directors and had an estimated cost of $25,000 to $30,000 for the first of three phases. However, there are no procedures in the grantee's Accounting Manual describing the process the Board uses to enter into consulting contracts. The grantee's Accounting Manual has limited policies on contracting. The section that covered purchasing was generally geared to purchasing supplies and did not address contracts for consultants. Two payments were made under this contract to the contractor totaling $31,500, yet no documentation was on file supporting the price increase or showing that the charges were in accordance with contract provisions. The contract had specific hourly rates for the different levels of staff involved in the project plus a 10% discount off of the standard rates. The two invoices paid did not provide any information on the hours worked, by whom, or at what rate. As such, the grantee could not determine if the invoices were in accordance with the contract terms and whether the payments were required under the contract.

In September 2008, another payment was made to the same contractor for $9,695. Since there was no additional contract or contract extension on file, the OIG could not determine from the information on file why that amount was paid. The grantee was able to provide documentation that, when questioned by accounting personnel, a Board member authorized the payment via email stating that the payment was approved and that the Board member had spoken to a grantor other than LSC about the payment.

A review of the vendor file and accounting records disclosed that all three payments were charged to LSC funds. Because the payments were not fully supported, the OIG is questioning the $41,195 in LSC funds paid to the contractor, and will refer this issue to LSC for review in accordance with 45 CFR § 1630.7.

> Recommendation 3. The Chief Executive Officer should develop written policies and procedures in the Accounting Manual specifically addressing consulting contracts. The written procedures should identify the documentation required to support payments to consultants and the process the grantee should use in obtaining contracted services. Such procedures should apply to the Board of Directors as well as management.

Grantee Comments.

The grantee agreed with the recommendation and provided written procedures for consulting contracts. The grantee disagreed that the costs of the consulting contracts identified in the finding should be questioned.

Grantee comments indicated the contracts were justified because of "…a recommendation by the Chief Executive Officer that a reduction in force of 60 to 70 members of the staff be immediately implemented due to a cash flow shortage." Grantee comments described the efforts of the Board of Directors, its officers, and the Executive Committee in addressing and correcting the serious financial situation. Grantee comments also indicated that the invoices were not required by the contract to be supported by specific time billing statements. The full text of grantee comments can be found at Appendix I.

OIG Evaluation of Grantee Comments.

Grantee actions are responsive to part of the recommendation. While the new procedures implemented for Client Matters may be adequate because of the small dollar amounts involved, the procedures do not sufficiently establish controls over consulting contracts for LANWT Matters. For example, the procedures do not establish dollar thresholds for obtaining competitive bids and do not give any indication as to what documentation or justification would be necessary for sole source contracts. The procedures do not indicate when the LANWT Board of Directors should be involved or when Board approval is needed. The Board bylaws have some guidance on what requires Board approval, but these requirements are not incorporated into the new procedures. The OIG considers grantee comments not fully responsive and will forward this issue to LSC management for action and resolution.

The OIG did not question the use of a contractor, but whether or not the payments were properly supported. A questioned cost is a cost that, among other things, is not adequately documented. The documentation on hand did not contain sufficient information to make a determination as to whether or not the invoice was in accordance with the contract provisions. The contract set forth rates of hourly pay depending on the position of consultant staff that worked on the contract. In addition, the contract provided for a 10% discount from the normal hourly rates. The invoice from the contractor did not disclose the position of the staff member who worked on the project, the hours worked, or the discount given. Thus the billing is not supported under the terms of the contract. For the third payment, the grantee provided no additional documentation to support the expenditure.

The OIG is questioning the $41,195 cost of the contracts because the expenditure is not adequately supported.

INTERNAL MANAGEMENT REPORTING AND BUDGETING

Internal management reporting and budgeting needs to be improved and the process strengthened. Although the practice currently in place appears to be generally in accordance with the *Fundamental Criteria* contained in the Accounting Guide for LSC Recipients, the grantee does not have written policies and procedures for its accounting and fiscal practices involving internal management reporting nor does the grantee detail the duties and responsibilities of accounting personnel for report preparation. In accordance with the *Fundamental Criteria*, policies, procedures and requirements for all report preparation should be determined and documented in an accounting manual.

While it appears that the Board of Directors is receiving the required information, the review of a sample of documentation provided to the Board of Directors indicated that Board members receive a large amount of data that did not include any explanatory material that would help interpret the data for the Board members. Also, the grantee could not provide written minutes of all the Board of Directors meetings and Audit Committee meetings for 2008, indicating that written minutes for all meetings did not exist. Therefore, we could not determine what Board members were told during Board and committee meetings about the data received. The Board may not be completely and fully informed by management of vital information necessary for the Board to adequately fulfill its oversight responsibilities. Furthermore, this lack of documentation in the minutes may result in misunderstandings between the Board and management on what was communicated and may impair effective board governance and oversight.

Recommendation 4. The Chief Executive Officer should develop written policies and procedures describing the grantee's current internal management and budgeting processes. These policies should take into consideration effective board oversight requiring that critical information be provided to the Board in a clear and complete manner.

Grantee Comments.

In response to the OIG's recommendation, the grantee stated as follows:

> *It is important to point out that the Report indicates that the Board of Directors is receiving required information. It also states that the program's practice that is currently in place is generally in accordance with the Fundamental Criteria contained in the Accounting Guide for LSC Recipients. This is also the*

> *finding of our independent financial auditors. The OIG suggests that Board members receive explanatory material that would help interpret the budget and other data. The Director and the Chief Financial Officer have already instituted a "narrative" explanation that is included with monthly financial statements and budget narratives will also be included in the adoption of budgets. We believe the program's Accounting Manual is extensive and provides the guidance for accounting personnel in the preparation of the reports. We will continue to review same to determine whether refinement is required.*

<u>OIG Evaluation of Grantee Comments</u>.

Grantee comments are not fully responsive to the recommendation. Although the grantee has instituted a narrative explanation in its monthly financial statements and the budget process, there is no indication that the internal reporting and budgeting processes have been formally documented and included in the Accounting Manual. In accordance with the *Fundamental Criteria*, policies, procedures and requirements for all report preparation should be determined and documented in an accounting manual. The resolution of this recommendation will be forwarded to LSC management for action.

<u>Recommendation 5.</u> The Chief Executive Officer should ensure that all Board of Directors meetings and committee meetings are properly documented in order to demonstrate that the governing body had adequately discharged its fiduciary responsibilities.

<u>Grantee Comments</u>.

In response to the OIG's recommendation, the grantee stated as follows:

> *This is a non existent problem. During the visit, the OIG was provided all minutes of all meetings in 2007 and 2008, save and except three meetings. We also provided minutes of selected meetings in 2006. The only minutes that were unavailable when the visit occurred were two committee meetings and one Board meeting in December 2008. These minutes had not yet been transcribed, i.e. reduced to writing. They were available on tape during the visit, as all meetings are recorded. They have since been reduced to writing. All meetings are well documented and reduced to writing in a timely*

fashion for subsequent meetings. They clearly demonstrate that the Board is discharging its fiduciary responsibilities.

OIG Evaluation of Grantee Comments.

The grantee represents that all Board and Committee meetings have now been documented. The comments state that the only minutes that were unavailable during the visit were those that had not yet been transcribed. During the visit, the grantee represented to the OIG team that other Board meetings had been held during 2008 but had not been formally documented. Recommendation 5 will remain open pending receipt of the aforementioned minutes.

ACCOUNTING MANUAL

The grantee's Accounting Manual was not complete or currently updated. The Accounting Manual appeared to be a collection of policies and procedures that had been in place at the predecessor grantee. The Accounting Manual did have many required sections such as sections on Cash Receipts, Petty Cash, Purchasing, Training/Travel, Payroll, Property, Cost Allocation, and Check Policies, but lacked policies or sections dealing with items such as internal management reports, budgeting, or contracting for services. While the Accounting Manual required three bids for certain purchases of supplies and equipment, there was no such requirement documented for services.

In establishing an adequate internal control structure, each grantee must develop a written accounting manual that describes the specific procedures to be followed to comply with the *Fundamental Criteria* contained in the Accounting Guide for LSC Recipients. Having a current and complete accounting manual helps ensure that proper controls are developed, documented and followed. The accounting manual also serves as a vehicle to communicate controls to all staff and ensures that staff members understand their roles and responsibilities.

Recommendation 6. The Chief Executive Officer should develop a revised and updated Accounting Manual that incorporates all essential policies and processes as required by the Accounting Guide for LSC Recipients and good management.

Grantee Comments.

In response to the OIG's recommendation, the grantee stated as follows:

> *This recommendation is merely a re-recital of Recommendations 3 and 4 to which we have responded. We will continue to review and update as necessary.*

OIG Evaluation of Grantee Comments.

Grantee comments are not responsive. While implementing appropriate policies in accordance with recommendations 3 and 4 would improve the existing manual, it does not address the overall issue of having a complete and current Accounting Manual. In accordance with the Accounting Guide for LSC Recipients, in establishing an adequate internal control structure, each grantee must develop a written accounting manual that describes the specific procedures to be followed by the recipient in complying with the *Fundamental Criteria*. At a minimum, the grantee should be able to demonstrate that it has reviewed its Accounting Manual in conjunction with the recommendation and has documented its conclusion on why it believes that the current Accounting Manual is satisfactory. The resolution of this recommendation will be forwarded to LSC management for action.

CONTROLS OVER COMPLIANCE

LSC regulation 45 CFR Section 1610.8 requires the Board of Directors to annually certify to LSC the grantee's compliance with LSC's program integrity requirements. An LSC program letter requires the grantee's executive director to submit a written report to the Board on the grantee's compliance.[1] Until 2008, these written reports had not been provided to the governing body for its preparation of the Certification of Program Integrity.

In the OIG's initial document request, the OIG requested the following: "A copy of the Executive Director's written reports to the governing body supporting the recipient's annual Certification of Program Integrity to LSC for the years 2007 and 2008." At the entrance conference, the Director of Administration explained that for the years preceding 2008, no written reports had been submitted to the governing body. He stated that during that period of time the reports were always given orally. He further explained that he had prepared a written report for 2008 for submission to the Board, which was provided to the team, and that the grantee would adhere to the requirement in the future.

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[1] Memorandum from John A. Tull, Director, Office of Program Operations, to all LSC Program Directors and Board Chairs regarding "Certification of Program Integrity" (Oct. 30, 1997).

Since the proper submission of the report in the future will adequately address the OIG's concern relating to the requirement, no recommendation is necessary at this time and the issue is considered closed.

PENALTIES

Penalties are not recognized as ordinary and necessary expenditures for the performance of LSC grants. A good financial management system should prevent the incurrence of unnecessary and unreasonable expenses such as penalties or late fees. Under LSC regulation 45 CFR § 1630.3 costs may be questioned if they are not reasonable and necessary for the performance of the grant. "A cost is reasonable if [among other factors] in its nature or amount, it does not exceed that which would be incurred by a prudent person under the same or similar circumstances." (See also the LSC Management Advisory[2] issued this past year.)

In preparing for this audit, it came to the OIG's attention that the grantee had used LSC funds to pay IRS penalties for excess contributions to a defined benefit pension plan. According to the grantee, the plan had not been previously adhered to and so the grantee had been assessed with IRS penalties totaling $5,000.

Subsequent to our discussion with grantee management, the grantee reallocated the expense to non-LSC funds. Since this adequately addresses the OIG's concern relating to a questioned cost involving the use of LSC funds, and since the OIG has already recommended that the Accounting Manual be updated to include all essential policies (see Recommendation 6), no further recommendation is necessary at this time and the issue is considered closed.

[2] Advisory from the President, Legal Services Corporation, to all LSC Executive Directors regarding "Fiscal Management and Use of LSC Funds" (March 20, 2008)

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July 22, 2009

Mr. Ronald D. Merryman
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Re: Response to Report on Selected Internal Controls
Legal Aid of NorthWest Texas, June 2009

Dear Mr. Merryman:

We are in receipt of the above-referenced Report. During the exit conference of February 27, 2009, we were told there would likely be a follow-up visit to further discuss some of the matters now contained in the Report, particularly Items 1 & 3. As we did not have that opportunity, we will address them here. Please consider this communication as our formal response to the matters contained therein. We will address the Audit Findings and Recommendations in the order in which they are presented. We would first like to acknowledge the professionalism of the team of Inspectors General who visited the program. While remaining at arms length during the audit, they were all courteous, engaging, and respectful of staff time devoted to the audit.

Audit Finding and Recommendation 1, Construction Costs.

Without any apparent background or expertise in architectural design and engineering, or knowledge of the downtown Fort Worth design requirements, the OIG concludes that the stone used for the exterior and interior of the entryway appears to be only "decorative in nature". That is simply not the case. Accompanying this Response is a letter from Mr. Benjamin Smith, AIA and Project Manager detailing considerations given to the selection of the material used for the entryway. That correspondence is incorporated herein by reference and describes the engineering and design challenges facing the project team. It is also important to understand the history of this project and the countless hours expended by the LANWT Board of Directors, and in particular, the ad hoc Building Committee.

The planning, design and construction of the new office building in Fort Worth spanned a period of three (3) years, one year of planning, one year of design, and a year to construct.

Recognizing the time constraints of the Inspector team, it would have been impossible for them to have reviewed the history of the project and all of the work and effort put in by a Board of Directors comprised of respected attorneys and dedicated client members. It is important however to put the entire project into proper context rather than simply question a material used in the construction of the building.

The decision to demolish the existing building and rebuild a new facility was not taken lightly. The former home of West Texas Legal Services[1] had been at the corner of Weatherford and Pecan Street in Fort Worth for twenty three years. The building was originally constructed as the United Methodist Church and later occupied as a community center. Located three blocks from the Tarrant County Courthouse, it became known by all in the community as the legal aid corner. Over the years, modest renovations were made but the building as a whole became unsuitable for continued occupancy, with limited parking, substandard mechanical, electrical and plumbing systems and marginal compliance with accessibility standards.

After a year long, well documented and detailed examination of the options available, the Board of Directors chose to rebuild at the same location while preserving the historical nature of the site.[2] The Board then sought the services of architects and engineers to design the building. After presentations from a number of firms, the architectural and engineering firm Multatech was selected to design and oversee the construction. There were numerous challenges encountered in the planning and design of the building. Environmental remediation was required with the demolition. The original footprint of the site needed to accommodate an office that would be 35% larger than the previous building.[3] It also had to be built maximizing parking space for staff and our client community. Most important, as new construction, it now had to meet the new Fort Worth Urban Design Standards and gain approval of the Downtown Design Review Board.[4] Because the LANWT office is located on the *gateway* to the downtown area, the Review Board was particularly attentive to the design and construction of the building. Permitting, and variances thereto, required constant diligence and patience from the consulting architects, the Building Committee and the Board of Directors.[5] Because the Board of Directors and LANWT management lacked the real expertise to oversee the project, an independent Project Manager was selected to represent the interests of the program in city negotiations, architectural planning and actual construction.[6]

After a full year of planning and design, construction bids were obtained and RJM

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1 In 2003, West Texas Legal Services merged with Legal Services of North Texas and changed its name to Legal Aid of NorthWest Texas.

2 During demolition of the old church building, a buried time capsule was uncovered. The contents were opened at a public ceremony attended by local civic and church leaders.

3 During preliminary designs, attempts were made to preserve the original frontal façade of the historic building but it limited the available space for constructing the new building and did not allow the use of the entire footprint.

4 Downtown Fort Worth has undergone a complete urban transformation that is unparalleled. The LANWT office is located within this transformation boundary as well as the Fort Worth Public Improvement District No. 1.

5 Among other considerations, the architectural treatment of the *gateway* corner was made more important to gain approval of the front set-back variance to move the building to within one inch of the property line.

6 Through the efforts of the Project Manager, value engineering resulted in a $100,000 reduction in the original construction budget.

Contractors, LP was chosen to complete the project. The process finally ended twelve months later, in December 2008. Over the three year period, the Board and management exercised proper due diligence to ensure the project's success and cost effectiveness. Indeed, with the attractive financing offered by our financial partner Frost Bank, the construction of the building and the resultant mortgage payment will allow the program to realize *annual* savings of between \$154,000 and \$371,000 over the next ten years.[7] These are very real savings that will directly impact client services.

As recited in the Report, a cost is reasonable if (among other factors) in its nature or amount, it does not exceed that which would be included by a *prudent person under the same or similar circumstances* prevailing at the time the decision was made to incur the cost [emphasis added]. The Board of Directors and management employed the services of experts to assist them in this very complicated and difficult project. Literally hundreds of hours were expended over a three year period overseeing its successful completion. Reliance was placed on those that had the experience to design and build in accordance with all applicable local and state standards for the construction of a multistory office building in a vibrant urban setting, accessible by our client community and just steps from the courthouse where they seek justice. In this instance, collective decisions were made by scores of prudent persons acting diligently in the performance of their roles as board members and management over a three year period. It is inferred that perhaps they should have engaged themselves in the selection of all materials used in the construction.[8] Considering the challenges faced and the complexities of local codes and construction requirements, that would have been unrealistic. Reliance had to be placed on the experts. Thus, the question is one of pluralism, i.e. whether, during the course of three years of decision making, another group of prudent individuals, with the advice and counsel of experts in the field, would have collectively made the same decisions given the totality of the circumstances presented in an ever evolving project such as this.[9] We are confident they would have, and believe the conclusion made by the Inspector General to question the reasonableness of the cost lacks foundation and is unwarranted.

Audit Finding and Recommendation 2, LSC's Reversionary Interest.

The LSC's property interests are protected. West Texas Legal Services purchased the original building with the approval of the LSC and entered into a property agreement. The property agreement reflects the interest of the LSC in the real property records using its legal description. West Texas Legal Services was the surviving corporation in the merger with Legal Services of North Texas. The name change did not affect the validity of the instrument. This was the conclusion reached by both the LSC and LANWT. Nevertheless, LANWT is merely

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7 In addition to triple net costs and parking expenses, leasing similar space would range between \$19.35 and \$30.20 per square foot, with potential increases in the years ahead. This compares to a mortgage of \$11.65 per square foot which is fixed for ten years.

8 Assuming *arguendo* that the board would have had the engineering expertise to question the selection of an alternative material for the entryway *and* the city's Design Review Board would have allowed the material to be used, a simple brick and stone cast entryway (the architect's reference to a "brown box") would have resulted in a mortgage of \$11.11 per square foot.

9 It is also important to point out that the interior space is primarily drywall and paint and these board members sit on folding chairs at folding tables during their hours long board meetings.

waiting for the LSC to provide a revised property agreement to execute and file with the deed records. We will do so upon receipt of the instrument, which is routinely prepared by the LSC, not the grantee.

Audit Finding and Recommendation 3, Consulting Contracts.

The Audit finding and the OIG's recommendation involve two separate issues. In the first instance, the report questions the use of LSC funds in the payment of costs associated with a consulting firm. It then makes a recommendation to develop written policies and procedures in the Accounting Manual specifically addressing consulting contracts. We will first address the payments to the consulting firm.

In late May 2008, the Board of Directors was presented with a recommendation by the Chief Executive Officer that a reduction in force of 60 to 70 members of the staff be immediately implemented due to a cash flow shortage. While acknowledging that some reductions were required, the Board was shocked with the recommendation. The Board lost confidence in its CEO and program leadership. The Board immediately garnered its collective wisdom and engaged the services of a management consulting firm to assess the program's fiscal situation. On June 23, 2008 the selected firm was engaged pursuant to a written contract that is best described as a *turnkey plus* arrangement. The consulting firm was to perform financial services on behalf of LANWT. The contract provided for an initial analysis of the critical issues LANWT faced with respect to its cash constraints for a predetermined cost. This was recited as Phase 1 of the Agreement. In this respect, it is not dissimilar to an audit engagement. As time was of the essence, the agreement provided for a very quick turnaround by the consultants with a verbal interim report on or before July 3 and a written report as soon as practical thereafter.[10]

Because the Board was uncertain of the findings that might be made, the agreement also included additional services that would be performed after the Phase 1 report was completed. These were recited as Phase 2 and Phase 3. This is the *plus* of the turnkey product where it is anticipated that additional services will be required. The Phase 1 report concluded that the program's cash flow was in a downward spiral. The Treasurer of the Board was charged with overseeing the program's fiscal situation while the Board addressed the problems. The Treasurer was in constant communication with the consultants and the program's Chief Financial Officer. On August 16, a specially called meeting of the full Board of Directors was held. Most of that meeting was held in Executive Session due to the subject matter. Upon exiting the Executive Session three and one half hours later, the Board suspended the CEO. The Board further authorized the Executive Committee to enter into an agreement with the consulting firm for turnaround services as provided in Phase 2 and 3 of the original agreement. It was fully contemplated that, while the full range of services and cost of Phase 2 and 3 would be negotiated, the consultant's continued analysis of the cash flow problems was essential to the program. The Treasurer asked for and the Board received continual analysis and updates from the consultants through August 2008. While these interim services (between Phase 1 and 2) and their cost were not specifically included in the written agreement, the agreement did provide for additional

10 The written report was provided to the Board on July 11, 2008.

services that might be needed from time to time.

The Executive Committee did proceed with negotiations for Phase 2 and 3, but ultimately the Board of Directors did not engage the consultants for these turnaround services. It nevertheless benefited from the interim services provided by the consultants and was obligated to compensate them through August 31. The Inspector General questions all payments made to the consultants because the invoices were not supported by specific time billing statements. They were not required pursuant to this contract. The Board engaged them to perform a specific service and they completed the assignment. The Board needed them to continue their analysis while it made critical decisions concerning the program's overall situation. These interim services were provided at a cost determined to be reasonable.

Between May 30 and August 31, the Board of Directors, its officers and the Executive Committee worked tirelessly to assess the program's leadership and fiscal dilemma. The decisions made and the actions taken during this three month period were based upon prudent business judgment, safeguarding program assets and maximizing efficiencies while continuing vital services to our client community. In the end, this collective effort resulted in a sound financial plan that avoided a year end budgetary crisis. The payment of services for the consultants should not be questioned by the OIG.

Secondarily, the OIG recommends the development of written policies and procedures specifically addressing consulting contracts. LANWT has done so. A copy of same accompanies this Response.

Audit Finding and Recommendation 4, Internal Management and Budgeting.

It is important to point out that the Report indicates that the Board of Directors *is receiving required information*. It also states that the program's practice that is currently in place *is* generally in accordance with the Fundamental Criteria contained in the Accounting Guide for LSC Recipients. This is also the finding of our independent financial auditors. The OIG suggests that Board members receive explanatory material that would help interpret the budget and other data. The Director and the Chief Financial Officer have already instituted a "narrative" explanation that is included with monthly financial statements and budget narratives will also be included in the adoption of budgets. We believe the program's Accounting Manual is extensive and provides the guidance for accounting personnel in the preparation of the reports. We will continue to review same to determine whether refinement is required.

Audit Finding and Recommendation 5, Documentation of Board and Committee Meetings.

This is a non existent problem. During the visit, the OIG was provided all minutes of all meetings in 2007 and 2008, save and except three meetings. We also provided minutes of selected meetings in 2006. The only minutes that were unavailable when the visit occurred were two committee meetings and one Board meeting in December 2008. These minutes had not yet been transcribed, i.e. reduced to writing. They were available on tape during the visit, as all meetings are recorded. They have since been reduced to writing. All meetings are well documented and reduced to writing in a timely fashion for subsequent meetings. They clearly demonstrate that the Board is discharging its fiduciary responsibilities.

Audit Finding and Recommendation 6, Accounting Manual.

This recommendation is merely a re-recital of Recommendations 3 and 4 to which we have responded. We will continue to review and update as necessary.

Respectfully Submitted,

Errol A. Summerlin
Chief Executive Officer

MULTATECH
Architecture · Engineering

July 15, 2009

Mr. Errol Summerlin
Legal Aid of NorthWest Texas
600 E. Weatherford
Fort Worth, Texas 76102

Re: Report by Inspector General about Stone Cladding

Dear Errol:

You asked that we review the audit and recommendations recently presented by the General Inspector. While we respect the intent of the report, we feel that we must take issue with the opinion that the stone cladding was merely "decorative" in nature.

The selection of the stone was not taken lightly and is a vital component of an overall building design that was required to satisfy the needs of all interested parties. We were charged by the client to provide an appropriate building design that would represent their regional headquarters and meet the construction budget. We were required to meet the Fort Worth Urban Design Standards and gain approval of the Downtown Design Review Board. We went through extraordinary efforts to gain the support of the neighbors so that opposition would be kept to a minimum during the multiple public hearings that were held on the design. Had we merely designed an ordinary brown box, I would dare to say that we would not have been allowed to move forward. Please allow us to elaborate on how we arrived at the design solution so that you might be persuaded that the stone is an important feature of the building.

The Urban Design Standards dictate that new buildings should fit within the context of architecture of downtown Fort Worth and should include "building edge" features such as façade articulation, tower focal points, use of multiple materials and numerous other considerations. These standards may be viewed at the following website:

http://www.dfwi.org/content/udbuild.pdf

The Downtown Design Review Board reviews all projects under their purview and has the authority to stop construction if it does not meet the Urban Design Standards. LANWT was also sensitive to the historic nature of the existing building. It was originally constructed as a Methodist Church in the late 1800's and had served their needs for many years.

We designed the building with the intent to reflect both worlds by including materials that represented the past as well as include a more contemporary

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feel. The majority of the building is clad in brick. The lower portion is a darker blend, while the upper half is lighter. This has a direct reference to the old Methodist Church, which was designed in a similar way. This was only two materials however and we needed more to satisfy the intent of the Design Standards. We decided that the design needed a material that served as not only an accent but a figurative beacon and portal to the present as well as a literal portal into the building. The white stone wall was the key contemporary component that we decided to use.

The argument has been made that the white stone wall appears to be an extravagant expense. I might agree if the stone was a conventional heavy dimensional stone. This is, however, an illusion. It is actually a quarter-inch thin stone veneer that is laminated to a light-weight honeycombed metal lattice. The entire system is clipped onto a CMU wall. We got more stone out of a typical slab due to the thinness of the veneer. Because of these light weight panels, installation went extremely fast and the foundation was not required to support a significant load as had we might using dimensional stone.

Why was a Travertine stone from Italy selected? It is a fair question that needs to be addressed. The brick was selected before the stone; we only knew we wanted the stone to be white in color. We seriously looked at the local stones along with the imported ones. Compared to the brick that we selected, many of the local selections either looked too tan or had a yellowish cast. The more white stones were relatively featureless and looked almost like white concrete. In addition, many of the local stones were very porous and chalky. We kept coming back to the Travertine that is currently installed. Compared with the brick, it had the color and texture we were looking for as well as being relatively non-porous and resilient. From a life-cycle cost point of view, we feel it is an outstanding material.

While the white stone veneer may appear to be expensive, we feel that it compares favorably to a conventional dimensional stone wall because of the thinness of the veneer and lighter weight construction methods.

Should you have any questions, please contact me at (817) 877-5571.

Sincerely,

Benjamin Smith, AIA
Project Manager

Cc: Jerry Morgan, Construction Management and Construction

INDEPENDENT CONSULTING CONTRACTS/AGREEMENTS

The following procedures are adopted to monitor consulting arrangements. The purpose of the policy is to ensure the consideration of appropriate factors in the selection of consultants in accordance with subparagraph 35(b) of Attachment B to OMB Circular A-122.

Client Matters

In the event a consultant is needed to further the interest of a client matter, it is the responsibility of the Managing Attorney to initiate an independent consulting agreement prior to the utilization of services. It is the Managing Attorney's responsibility to determine the nature and scope of services, the necessity of contracting for the service, to confirm that the services cannot be performed by staff, and confirm the qualifications of the consultant.

The resultant agreement with the consultant shall be in writing, duly signed and dated by the parties and should include the following:

1. The scope of services,
2. The staff person who will coordinate the performance of the services to be provided and to whom the consultant will be answerable,
3. Fees and expenses, whether same are based upon a lump sum or time and billing, and the requirement of any advances or interim payments,
4. Start and ending dates of the agreement and a recitation of any potential extensions of time and/or additional services,
5. A recitation that the consultant is an independent contractor,
6. A statement of confidentiality, and
7. Professional liability insurance, if applicable.

All requests for payment, either interim or final, shall be approved by the Managing Attorney and shall be submitted with an Invoice or other proper documentation to Accounting.

The Managing Attorney may approve consulting contracts up to a total cost of $500. The Director of Litigation or Regional Counsel may approve consulting contracts up to a total cost of $1,000. Executive Director approval is required for consultant contracts exceeding $1,000.

LANWT Matters

In the event a consultant is needed to further the interests of the program, the Executive Director or his designee shall be responsible for adherence to the above-recited policy and procedure. In the rare event that the Board of Directors should determine the necessity for consultant services, the Board of Directors, or its designee, shall be responsible for adherence to this policy.