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Legal Services Corporation

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January 15, 2013

Paul E. Furrh, Jr.
Executive Director
Lone Star Legal Aid
1415 Fannin Street
Houston, TX 77002

Dear Mr. Furrh:

Enclosed is the Office of Inspector General's (OIG) final report of our audit on Selected Internal Controls at Lone Star Legal Aid (LSLA). The OIG has reviewed your comments on the draft report findings and recommendations and has determined that the actions LSLA has planned or taken relating to Recommendations 1, 3, 4, 5, 6, 7, 8, and 9 are responsive. The OIG has closed Recommendations 5, 6, 8, and 9. Recommendation 2 was only partially responsive because the comments did not address all aspects of the recommendation. Recommendation 2 will be referred to LSC management for resolution. The full text of your comments is included in this report as Appendix I.

The OIG is referring \$45,762 in questioned costs to LSC management for their determination. These costs involve unsupported credit card charges, purchases exceeding \$10,000 for which LSC prior approval was not obtained, and physical inventory items that could not be located.

Thank you for your cooperation and courtesy.

Sincerely,



Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman
President

Lynn A. Jennings
Vice President for Grants Management



**LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL**

REPORT ON SELECTED INTERNAL CONTROLS

LONE STAR LEGAL AID

RNO 744060

Report No. AU13-02

January 2013

www.oig.lsc.gov

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INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Lone Star Legal Aid (LSLA or grantee) related to grantee operations and oversight. Audit work was conducted at the grantee's main office in Houston, Texas, and its branch offices in Nacogdoches, Waco and Angleton, Texas. Five separate on-site visits were conducted from August 2010 through January 2011.

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:

The 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:

- 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.

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 preventing defalcations and meeting the complete financial information needs of its management.

BACKGROUND

LSLA was formed in December 2001 after the merger of three legal aid organizations, East Texas Legal Services (ETLS), Gulf Coast Legal Foundation and portions of Legal Aid of Central Texas. The grantee's headquarters is in Houston, Texas. The grantee provides free legal services to low income individuals. In 2010, the grantee operated out of 14 offices located in East Texas counties, served clients in Southwest Arkansas and employed a staff of 227 attorneys, paralegals and administrative staff. In addition to funding from LSC, the grantee receives funding from the U.S. Department of Justice and the U.S. Department of Health and Human Services. It also receives grants passed through the Texas Equal Access to Justice Foundation. Those grants are for the: Basic Civil Legal Services program, Crime Victims Civil Legal Services program, and Parenting Order Legal Clinic Project. According to LSC data for calendar year 2009 and 2010, the grantee received LSC funding of \$10,226,812 and \$11,042,283 respectively.

OBJECTIVE

The overall objective was to assess the adequacy of selected internal controls in place at LSLA as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability and compliance with selected LSC regulations. We also reviewed other specific issues that were communicated to our office prior to our visit. The audit evaluated selected financial areas and tested related controls to ensure that costs were adequately supported and allowed under the LSC Act and LSC regulations. In addition, the audit determined whether controls were properly designed to ensure compliance with the LSC Act and the LSC regulations selected for review. The audit did not however evaluate compliance with the selected LSC regulations.

SCOPE AND METHODOLOGY

To accomplish the objective, the OIG reviewed controls over disbursements, selected LSC regulations, and other areas that were brought to our attention. To obtain an understanding of the internal controls over these areas, we reviewed grantee policies and procedures, including manuals, guidelines, memoranda and directives setting forth current grantee practices. Grantee management officials and staff were interviewed to obtain an understanding of the internal control framework, their knowledge and understanding of the processes and to give explanations for other issues brought to our attention. Documentation supporting financial transactions recorded by the grantee was reviewed to test the controls 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.

Fieldwork was conducted at LSLA's headquarters located in Houston, Texas and at field offices located in Waco, Angleton and Nacogdoches, Texas. With respect to fieldwork performed at Houston, we tested the controls over and the appropriateness of expenditures by reviewing invoices, vendor lists and general ledger details. We judgmentally selected a sample of expenditures with an emphasis on employee reimbursements, and vendor files. The sample consisted of 190 disbursement transactions totaling \$692,585 and was drawn from expenditures made during fiscal year 2009 through October 31, 2010 and six selected 2008 disbursements. To assess the appropriateness of expenditures, we reviewed invoices, vendor lists, and general ledger details. The appropriateness of those expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance. We also examined documentation or conducted interviews related to specific issues that were communicated to us, prior to our audit, at each of the offices that we visited.

To evaluate 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. 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, reviewed applicable documentation and reports, and interviewed staff to determine if the controls were designed in a manner to ensure compliance with the provisions of LSC regulations reviewed.

Internal controls over employee reimbursements and written personnel policies and practices were examined. Additionally, employee reimbursements were judgmentally sampled and reviewed as part of disbursement testing.

The audit was limited in scope and was not sufficient for expressing an opinion on the entire system of the grantee's internal controls over financial operations or over LSC regulations.

Five separate on-site visits were conducted during the period August 2010 through January 2011. Audit work was conducted at the grantee's main office in Houston, Texas, its branch offices in Nacogdoches, Waco and Angleton, and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2009 to October 31, 2010 and six selected 2008 disbursements.

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 finding and conclusions based on the audit objectives. The OIG believes that the evidence provides a reasonable basis for the findings and conclusions based on the audit objectives.

OVERALL EVALUATION

Our audit found a number of significant problems with the design and operation of some of the internal controls reviewed at Lone Star Legal Aid. We noted that duties were not properly segregated in the areas of payroll processing, office supply purchases, maintenance of the vendor list and IT equipment purchasing. The grantee's disbursements tested were, for the most part, adequately supported and allowable. However, we did find charges that we believe should not have been charged to LSC funding. These included \$7,681 of unsupported credit card charges¹, charges for two airline tickets that were not adequately supported and the purchase of flowers and other

¹ Subsequent to the draft report, grantee management provided additional documentation that fully supported five of the transactions and partially supported six other transactions. We have reviewed the additional documentation and will reduce the amount of questioned costs associated with unsupported or unnecessary transactions from \$7,681 to \$4,639.

“get well” items for personal life events of employees. We also found \$40,458² in purchases greater than \$10,000 in which the grantee did not obtain the required prior LSC approval. Lastly, we could not physically locate 40 items of untagged IT equipment that were in the grantee’s property records totaling \$19,628³. The OIG is questioning \$45,762 of these costs (adjusted as reflected in footnotes 1 and 2) and will refer the questioned costs to LSC management.

The grantee’s written policies and procedures appear to be adequate and in accordance with LSC’s *Fundamental Criteria* except for the cost allocation methodology. Policies and procedures related to the cost allocation process need to be documented in the grantee’s accounting manual. The grantee’s budgeting and management reporting process appeared adequate and to be operating effectively. Our testing of contracting and related controls did not identify any reportable issues. Controls over the selected regulations reviewed were designed in a manner expected to ensure compliance with the LSC Act and LSC regulations.

Summary of Grantee Comments

The grantee included a general comment in its response that stated a new Chief Financial Officer (CFO) was hired and began working for the program in May 2012. The general comment also stated that the CFO has been tasked to review, develop, and supplement LSLA’s accounting manual, policies and procedures where necessary, and ensure that policies, procedures and practices are followed and enforced. The grantee agreed with all nine recommendations and has or will take appropriate actions to implement the recommendations.

The full text of grantee management’s comments can be found at Attachment I. A summary of management comments can be found after each recommendation or series of recommendations.

OIG Overall Evaluation of Grantee Comments

Grantee actions taken or planned are responsive to eight of the nine recommendations, and partially responsive to one recommendation. Also, the OIG considers four of the nine recommendations as closed. The grantee’s response to Recommendation 2 is considered partially responsive because management did not address all aspects of the recommendation. Grantee management disagreed with the finding and questioned cost associated with obtaining prior approval from LSC for major acquisitions. However, management is taking action to fully implement the recommendation. The OIG’s

² Prior to issuing the final report, LSC issued an internal opinion stating that maintenance and service costs are not used to determine if a purchase exceeds the \$10,000 threshold requiring LSC prior approval. Following that opinion for purposes of this report, the finding and questioned costs contained in the draft report addressing LSC’s prior approval requirement for purchases over \$10,000 were updated to reflect LSC’s position. The OIG is therefore reducing the questioned costs for this finding to \$40,458 from the \$60,124 identified in the draft report.

³ Subsequent to issuing the draft, the grantee provided the specific location for 37 of the 40 assets that could not be located while the audit staff was on site. We have reviewed the information provided and will reduce the amount of questioned cost from \$19,628 to \$665, the cost of the remaining three items.

specific evaluation of management's comments can be found after the Grantee Comments section for each finding.

The OIG will refer question costs totaling \$45,762 to LSC management. This includes \$40,458 for acquisitions made without LSC approval that exceeded \$10,000; \$4,639 for disbursements that were either unsupported or not allowed; and \$665 for three missing pieces of equipment. These amounts reflect the revised amount based on additional information supplied by management (see footnotes 1 and 2).

AUDIT FINDINGS

CONTROL DEFICIENCIES

Controls needed to be strengthened in several areas. These controls include segregation of duties, documenting the cost allocation process, managing IT equipment, obtaining approval from LSC for purchases over \$10,000, ensuring expenditures are documented and ensuring only allowable expenses are charged to LSC funds. As a result, the OIG is questioning \$40,458 for three purchases that did not receive required prior approval from LSC, \$4,639 of unsupported and unnecessary charges to LSC funds and \$665 for three items of IT equipment that could not be located⁴.

Segregation of Duties

LSLA did not segregate duties for four major businesses processes. These processes were payroll, office supply purchases, maintenance of the vendor list, and IT equipment purchases.

According to LSC's Accounting Guide

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

Without properly segregating duties, there is an increased possibility that misappropriation, concealment, or theft could happen and not be discovered timely.

⁴ The questioned cost amounts were modified after the draft report was issued based on additional information provided by the grantee. The original numbers were \$7,681 of unsupported and unnecessary charges to LSC funds and \$19,628 for 40 items of IT equipment that could not be located. The original amounts will be used as support for the findings.

Payroll

The Assistant Business Manager, who processes payroll, had rights and privileges within the payroll system that allowed the Manager to process transactions without a second independent individual being involved. The Manager could perform the following in the payroll system without additional authorization or oversight.

- Process payroll and send the information to the payroll processing vendor—ADP.
- Establish new employees.
- Change pay rates.
- Add overtime pay to employees.

Moreover, the Director of Finance (DOF), the Manager's immediate supervisor, did not provide adequate oversight of the payroll process. A detailed review of payroll was not performed prior to submission of the information to ADP or after the payroll and supporting schedules were returned or made available for online review.

Office Supply Purchases

The Supply Coordinator, who is responsible for maintaining an adequate office supply stock for the main Houston office and the ancillary offices, ordered supplies, received the goods, and approved them for payment. Our discussions with the Supply Coordinator disclosed that he seeks approval from the Chief Operating Officer prior to ordering supplies, but does not maintain evidence of that approval. He also informed us that when he receives office supplies, he would discard the corresponding receiving reports. Of ten office supply purchases reviewed, totaling \$35,163, no receiving reports were on file. Consequently, we were unable to confirm the receipt of the office supplies.

LSLA has a written policy in its accounting manual requiring a three way match with the purchase order, invoice, and receiving report prior to making payment. Without documented prior approval of purchases and without receiving reports on hand, we could not confirm that the goods purchased were authorized by appropriate officials and that those goods were actually received by the program.

Maintenance of the Vendor List

The Accounting Secretary maintained the vendor list and was significantly involved in the disbursement process. With respect to the maintenance of the vendor lists, the Accounting Secretary could perform the following:

- Add a vendor in the accounting system.
- Change vendor addresses.
- Change vendor phone numbers.

The Accounting Secretary also performs the following with respect to the disbursement process:

- Receives invoices.
- Sends invoices out for approval.
- Prepares the check requests.
- Enters the disbursement information into the accounting system.
- Sends the invoice, check request and check out for approval.
- Mails the checks.
- Files the check copy and other supporting documentation.
- Has access to the check stock.

Having the ability to add vendors, change vendor addresses and change vendor telephone numbers along with significant disbursement responsibilities could result in unauthorized vendors being paid with program funds and without management's knowledge.

IT Equipment Purchases

According to the Director of Information Services, who is responsible for purchasing IT equipment, he initiates purchases when equipment is needed. The equipment comes to both the main Houston office and to the field offices, where it is received from the vendors. When the invoices arrive, he reviews them for adequacy, approves them and then forwards them to the accounts payable department for payment. Having the ability to initiate a purchase, receive the goods and approve them for payment increases the risk that fraud or misappropriation could occur and not be detected in a timely manner.

Recommendations: The Executive Director should:

Recommendation 1: Implement written policies and practices to ensure that duties are properly segregated in the areas discussed above.

Recommendation 2: Ensure that the payroll process is properly supervised and that detailed reviews of payroll are conducted prior to submission to ADP for processing and after the payroll and supporting schedules are returned or made available for online review.

Recommendation 3: Enforce LSLA's policy requiring a three way match with the purchase order, invoice, and receiving report prior to making payment.

Grantee Comments: The grantee stated that a new policy on internal control structure and segregation of duties was created that modifies the previous policy and procedures for internal control for payroll, office supply purchases, maintenance of the vendor list and IT equipment purchases. The new policy requires at least two persons to be involved in all of the above mentioned areas. The policy was approved at the grantee's board meeting on September 22, 2012.

In response to ensuring that the payroll process is properly supervised and reviewed, the grantee stated that procedures utilizing the existing controls provided by their

payroll-processing vendor, ADP, were implemented. The grantee stated that the person responsible for payroll will no longer have access to the human resources function.

With regard to enforcing its policy requiring a three-way match with the purchase order, invoice and receiving report prior to making payment, the grantee stated that the Executive Director has reviewed the policy and instructed the CFO to enforce it. Moreover, the grantee added additional controls for office supply purchases. Specifically, all payment processing for office supplies will require a three way match before payment. As to the vendor setup process, the individual responsible for printing and processing checks no longer has access to the vendor setup/edit function in the accounting software. The individual must now request in writing that the general accountant, create or edit vendor records.

OIG Evaluation of Grantee Comments: The OIG considers grantee management's actions planned and taken to be responsive to Recommendations 1 and 3, and partially responsive to Recommendation 2. For Recommendation 2, grantee management comments did not address how proper supervision and oversight of the payroll process would occur or how detailed reviews of the payroll would be conducted prior to submission to ADP for processing.

The OIG considers Recommendations 1 and 3 open until notified in writing that policy has been incorporated in the grantee's accounting manual and implemented. The OIG considers Recommendation 2 as open and will refer the recommendation to LSC management for further action.

Cost Allocation Process Not Documented

The grantee's cost allocation system was not documented in the grantee's accounting manual. As a result, the OIG was unable to determine if the system design was adequate or if designed adequately, whether the system was in fact operating as intended. Unless the allocation process is properly designed, adequately documented, and accurately applied, the grantee cannot be assured that its costs are being allocated to LSC and other grantees in a fair, consistent, and equitable manner.

The LSC Accounting Guide provides that the allocation formula should be adequately documented with sufficient detail for the auditor, LSC, OIG, GAO and others to easily understand, follow, and test the formula.

Recommendation 4: The Executive Director should ensure that the cost allocation process is fully documented in LSLA's accounting manual.

Grantee Comments: Grantee management has created a new cost allocation policy and will ensure that the process is fully documented in its accounting manual. This policy was presented to the Board of Directors at a meeting on September 22, 2012, and approved.

OIG Evaluation of Grantee Comments: Grantee planned actions are responsive to the finding and recommendation. The OIG considers Recommendation 4 to be open until notified in writing by the grantee that the policy has been incorporated in its accounting manual and implemented.

Internal Controls over IT Equipment.

Internal controls over IT equipment need to be strengthened. Equipment items could not be located during our inventory. Property was either not tagged or not tagged in a timely manner. Physical safeguards over equipment need to be implemented. These deficiencies can have a significant effect on control over LSLA's IT equipment and could result in theft or misappropriation, which could go undetected.

Tagging of IT Equipment

The process of tagging equipment was not being performed adequately to ensure that all equipment was properly accounted for after being purchased. Tagging is a process where an identification marker such as a tag is placed on equipment to help identify the program's equipment and to keep track of the location of that equipment. IT property was either not tagged or property records were not updated with tagging information on a timely basis.

At the time of our audit, there was a significant time lag between when property was received and when tagging information was entered into the property records. The time lag was up to 2 months. The time lag resulted from either of two reasons.

- 1) Asset tags were never assigned upon LSLA receiving the equipment or when the equipment was subsequently issued; or
- 2) Asset tags were assigned; however, IT staff did not enter the information into the property records.

We conducted an inventory of 72 IT items, listed as untagged in LSLA's IT property records that was valued at approximately \$49,000. We identified 40 items, valued at \$19,628 that could not be physically located. Having accurate tagging information recorded could have helped keep track of the missing equipment. While LSLA's accounting manual requires that all property be tagged upon receipt and recorded in the property control system, the policy was not followed.

Subsequent to receiving the draft report, grantee management provided the OIG with information on the location of 37 of the 40 items identified in the finding. As a result, the OIG is only questioning \$665 for the three missing items charged to LSC funds as unallowable costs within the meaning of 45 CFR § 1630.2. The OIG will refer these costs to LSC management for review and action.

Safeguarding IT Equipment

New IT equipment was not adequately secured in a physical location under lock and key. There was no specific grantee policy on safeguarding IT equipment and most of the equipment was stored in the Houston office. An assortment of IT equipment was stored in the office of one IT employee, including laptops, desktops, video cameras, projector, monitors, monitor stands, and random digital media (USBs, CDs, hard-drives). Many of the items contained in this office were brand new, untagged, and not specifically accounted for in the property ledger. We observed that the employee's door was often left open and the room unattended. Any employee or visitor could walk in and remove equipment without being detected.

Recommendations: The Executive Director should ensure:

Recommendation 5: Policies on tagging equipment items are enforced.

Recommendation 6: All unissued IT equipment is securely stored at all times to avoid possible theft.

Grantee Comments: Grantee management stated that the Executive Director has instructed the CFO to review and reemphasize tagging procedures for all incoming equipment. The Executive Director has also instructed the CFO and Director of IT to securely store all unissued IT equipment. The grantee stated it has found all but 3 of the 40 IT items that the OIG could not locate during the audit.

OIG Evaluation of Grantee Comments: Grantee actions taken are responsive to Recommendations 5 and 6. The OIG will refer the cost of the three missing items totaling \$665 to LSC management for review and action. The OIG considers Recommendations 5 and 6 as closed.

LSC Prior Approval for Items over \$10,000

LSLA used LSC funds to make computer related purchases valued over \$10,000 without prior approval from LSC. LSLA made three purchases of computer software licenses totaling \$40,458 as shown below:

Vendor	Description	Amount
Automon LLC	License upgrade from 125 to 200 Users	\$13,178
Troubador, LTD	Software licensing	\$13,640
Troubador, LTD	Software licensing	\$13,640

According to the Director of Finance, the grantee's understanding of LSC's regulation 45 CFR § 1630.5, which governs purchases greater than \$10,000, was that prior approval had to be obtained for single items over the \$10,000 threshold. Since the purchases consisted of numerous items, each valued at less than \$10,000, the prior approval requirement did not apply. We disagree. In accordance with LSC's Property

Acquisition and Management Manual (PAMM), each of the three purchases constitutes a single acquisition.

PAMM Section 2(a), *Acquisitions*, requires grantees to "...treat a purchase or lease of related property as a single acquisition when the property can be readily obtained through a single contract with a single source." Further, Section 3(d) of the PAMM states:

A recipient using more than \$10,000 of LSC funds to acquire an individual item of personal property must request and receive LSC's prior approval pursuant to 45 CFR 1630.5(b)(2), whether or not the acquisition is to replace existing property, before making the expenditure.

As a result, the OIG is questioning \$40,458 charged to LSC funds for the purchase of the software licenses as unallowable costs within the meaning of 45 CFR §§ 1630.2 and 1630.5. The OIG will refer these costs to LSC management for review and action.

Recommendation 7: The Executive Director should ensure that required LSC approvals are obtained before making purchases.

Grantee Comments: Grantee management did not agree with the finding or the questioned cost. Specifically, management disagreed with the OIG's assessment that these purchases required prior approval in accordance with the PAMM requirements. The grantee stated that none of the purchases involved "individual items" of personal property that exceeded the \$10,000 charged to LSC. As such they do not believe the cost should be questioned.

However, the grantee has prepared a new policy which was approved by their Board of Directors on September 22, 2012, requiring prior LSC approval of expenditures greater than \$10,000. According to the Board resolution, this new policy will be added to the grantee's accounting manual.

OIG Evaluation of Grantee Comments: While management disagreed with the finding and questioned cost, the grantee's planned actions are responsive to Recommendation 7. A new policy that addresses prior LSC approval of expenditures greater than \$10,000 was approved by its Board of Directors on September 22, 2012.

The OIG believes that the purchases required prior LSC approval. The OIG will refer the total amount of \$40,458 as a questioned cost for LSC management's review. The OIG considers Recommendation 7 open until notified in writing by the grantee that the policy has been incorporated in its accounting manual.

Disbursements Not Adequately Supported

Our review of disbursements revealed 31 instances totaling \$7,681 out of 190 disbursements in our sample of \$692,585, where purchases had no supporting

documentation, were inadequately supported or were not allowable under LSC regulations. We observed the following:

No Supporting Documentation

Thirteen transactions made using the Executive Director's credit card did not have supporting documentation attached to the credit card statement. The purchases included meals, a U-Haul rental, and hotel stays. For five of these instances, meals were purchased, but the business purpose and the names of people in attendance were not provided with the receipt. The disbursements valued at \$4,398 were charged to LSC funds.

Inadequately Supported Disbursements

One disbursement involved the purchase of two airline tickets totaling \$802 to Washington, DC, but no invoice or receipt was included with the supporting documentation. The expense was included on a travel expense report that indicated the airline tickets were purchased for two staff members to attend a conference in Washington, DC. There was no itinerary or receipt attached to confirm what was claimed on the expense report. An invoice or receipt is required according to the grantee's disbursement policy. The expenditure was not adequately supported in accordance with the grantee's disbursement policy.

Unallowable Expenses

In 16 instances totaling \$2,481 other unnecessary or unallowable expenses were charged to LSC funds. These expenditures were for flowers and other "get well" items that were not consistent with the purpose of the LSC grant. LSLA's accounting manual includes a listing of allowable/unallowable items pursuant to OMB Circular A-122 and provides that unallowable items include things such as "Goods or Services for Personal Use," "Contributions and Donations," and "Entertainment."

Subsequent to receiving the draft report, grantee management provided documentation to the OIG fully supporting five of the disbursements and partially supporting six other disbursements. As a result, the OIG is questioning \$4,639 in disbursements as unsupported or unnecessary charges to LSC funds within the meaning of 45 CFR § 1630.2. The OIG will refer these costs to LSC management for review and action.

Recommendations: The Executive Director should

Recommendation 8: Enforce policies and procedures that require disbursements to be accompanied by adequate supporting documentation before payment.

Recommendation 9: Ensure that staff is aware which expenses are considered allowable and unallowable under LSC funding.

Grantee Comments: Grantee management stated that the Executive Director has instructed the CFO to enforce policies and procedures that require disbursements to be accompanied by adequate support before payment. The Executive Director also has reviewed allowable and unallowable expenses with the CFO and instructed the CFO to review all allowable and unallowable expenses with the staff connected with purchasing.

The grantee stated it was able to find support for a number of the unsupported disbursements that were identified in the draft report. The grantee stated that a review of the 16 instances totaling \$2,481 that the OIG listed as unallowable disclosed that the staff mistakenly charged the disbursements to LSC funds.

OIG Evaluation of Grantee Comments: Grantee actions taken are responsive to Recommendations 8 and 9. Upon review of the documentation that the grantee submitted with its comments, we are reducing the questioned cost amount for unsupported or unnecessary disbursements from \$7,681 to \$4,639, and referring this amount to LSC management for review and action. Recommendations 8 and 9 are considered closed.

**Response to Draft Report of the
LSC Office of Inspector General (OIG)
of Lone Star Legal Aid, August 2010 through January 2011
Recipient No. 744060**

Recommendations:

Recommendation 1: The Executive Director should implement written policies and practices to ensure that duties are properly segregated in the areas discussed above.

Recommendation 2: The Executive Director should ensure that the payroll process is properly supervised and that detailed reviews of payroll are conducted prior to submission to ADP for processing and after the payroll and supporting schedules are returned or made available for online review.

Recommendation 3: The Executive Director should enforce LSLA's policy requiring a three way match with the purchase order, invoice, and receiving report prior to making payment.

Recommendation 4: The Executive Director should ensure that the cost allocation process is fully documented in LSLA's accounting manual.

Recommendation 5: The Executive Director should ensure policies on tagging equipment items are enforced.

Recommendation 6: The Executive Director should ensure all unissued IT equipment is securely stored at all times to avoid possible theft.

Recommendation 7: The Executive Director should ensure that required LSC approvals are obtained before making purchases.

Recommendation 8: The Executive Director should enforce policies and procedures that require disbursements to be accompanied by adequate supporting documentation before payment.

Recommendation 9: The Executive Director should ensure that staff is aware which expenses are considered allowable and unallowable under LSC funding.

General Response: Following the OIG visit and Exit Interview on January 12, 2011, LSLA restructured its business office in consultation with the LSLA Board of Directors, began recruiting for a competent and experienced Chief Financial Officer, and hired a highly competent and experienced Chief Financial Officer who began in May 2012. Under the supervision of Executive Director, the CFO has been tasked to review the LSLA Accounting Manual existing policies, procedures, and to develop and supplement appropriate accounting policies, procedures, and practices where they are lacking, ensure that policies, procedures, and

practices are followed and where necessary documented, and enforce LSLA policies, procedures, and practices.

LSLA management agrees with these nine recommendations and has or will take appropriate action to implement them.

Specific responses to each recommendation follow.

Recommendation 1: Implement written policies and practices to ensure that duties are properly segregated in the areas discussed above.

Response: The attached *LSLA Policy Regarding Internal Control Structure and Segregation of Duties* modifies LSLA policy and procedures for internal control for payroll, office supply purchases, maintenance of the vendor list, and IT equipment purchases.

“It is the intent of Lone Star Legal Aid (LSLA) to establish and maintain policies and procedures to safeguard all corporation assets against unauthorized use or loss, ensure the reliability of financial information and reporting, and comply with regulations and laws that have a material effect on LSLA. To that end, at least two (2) persons will be involved in all cash receipt, payroll, cash disbursement and purchasing transactions and vendor lists. As outlined in policies and procedures throughout the LSLA Accounting Manual, a person who is responsible for incurring an expense or receiving cash will not be responsible for processing the item in the accounting system or final deposit or disbursement of the check. Periodically, all internal controls will be reviewed by Management to ensure that adequate internal controls are in effect and changes will be made where necessary.”

The Policy will be presented to the LSLA Board of Directors for approval at its next board meeting on September 22, 2012, and added to Section 203 of the LSLA Accounting Manual.

Recommendation 2: Ensure that the payroll process is properly supervised and that detailed reviews of payroll are conducted prior to submission to ADP for processing and after the payroll and supporting schedules are returned or made available for online review.

Response: The Response to Recommendation 1 also applies to Recommendation 2. In addressing the recommendation with the missing controls in the payroll function, LSLA implemented procedures utilizing the existing controls provided by our payroll-processing vendor, Automated Data Processing (ADP). Specifically, the individual responsible for processing payroll will only have access to the payroll function and not have access to the human resources function. The individual responsible for handling benefits will only maintain employee deductions and benefits. This added segregation of duties in the payroll function will provide additional protection to the payroll process.

Recommendation 3: Enforce LSLA's policy requiring a three way match with the purchase order, invoice, and receiving report prior to making payment.

Response: The Executive Director has reviewed LSLA's policy requiring a three match with purchase order, invoice, and receiving report prior to making payment and instructed the CFO to enforce it.

In addressing the recommendation with the missing controls in the office supply purchasing function, LSLA has reemphasized and added additional controls. Specifically, all payment processing for office supplies and other items requires the purchasing function to provide three matched documents: a purchase requisition with two signatures, a receiving document from someone outside of the purchasing function, and an original invoice. Requiring these documents before processing payments will aid in discovering errors, omissions, and irregularities in the purchasing function during the normal course of operations.

In addressing the recommendation with the vendor setup process, the management of LSLA removed access to the vendor setup/edit function in our accounting software, Fundware, from the individual responsible for printing and processing checks. This individual must request in writing for another member of the accounting office staff, the general accountant, to create or edit vendor records in Fundware. These additional controls will aid in discovery of errors, omissions, and irregularities in the vendor set up process.

Recommendation 4: The Executive Director should ensure that the cost allocation process is fully documented in LSLA's accounting manual.

Response: The attached *Cost Allocation Methodology Policy* will ensure that the cost allocation process is fully documented in LSLA's Accounting Manual. The *Cost Allocation Methodology Policy* will be presented to the LSLA Board of Directors for approval at its next meeting on September 22, 2012, and added as a new section to the LSLA Accounting Manual.

Recommendation 5: The Executive Director should ensure policies on tagging equipment items are enforced.

Response: The Executive Director has instructed the CFO to review and reemphasize procedures to tag all incoming equipment as received by all staff and communicate that information to Accounting via email using the Asset Form which has been in use for several years.

LSLA reviewed the 72 IT items, valued at \$19,628, the OIG report listed as missing and located all but three (3) items as a result of our recent inventory. Report sent separately. LSLA asks that the OIG review this report as it should reduce the amount of questioned cost.

Recommendation 6: The Executive Director should ensure all unissued IT equipment is securely stored at all times to avoid possible theft.

Response: The Executive Director has instructed the CFO and Director of IT to securely store all unissued IT equipment.

Recommendation 7: The Executive Director should ensure that required LSC approvals are obtained before making purchases.

Response: LSLA policy requires adequate policy and procedures to be in place to direct the staff on when LSC prior approval is needed and the procedure to follow. The attached *LSLA Purchasing Policy* codifies these procedures and will be presented to the LSLA Board of Directors for approval at its September 22, 2012 board meeting, and added as a new section to the LSLA Accounting Manual.

The OIG reviewed three LSLA purchases of computer software licenses and maintenance agreements totaling \$60,124. The Automon LLC purchase was for \$17,186. Automon makes and provides support for our Practice Manager Case Management System. LSLA ordered license upgrades from Automon for 75 additional users going from 125 to 200 at a cost of \$175.70 per user, for a total of \$13,177.50. In addition, LSLA purchased individual maintenance agreements for those 75 licenses at a cost of \$53.45 per user, for a total of \$4,008.26. The two Troubadour purchases of \$21,469 and \$21,469 were for maintenance agreements of varying amounts but all under \$5,000 each.

None of the above purchases involved “individual items” of personal property that exceeded \$10,000 charged to LSC. LSLA relied upon LSC past practice when charging the purchases in the manner it did. LSC’s established past practice is consistent with the language of the preamble to 45 CFR Part 1630.5 and the PAMM. We believed LSC prior approval was not required and the \$60,124.00 charged to LSC funds would be treated as allowable costs.

The OIG relies on the definition of “acquisition” in LSC’s Property Acquisition and Management Manual (PAMM) that grantees should “treat a purchase or lease of related property as a single acquisition...” PAMM, Section 2(a). The OIG further relies on the prior approval requirements found in 1630.5(b) (2) that prior approval is required “if the current purchase price of any individual item of property exceeds \$10,000” and Section 3(d) of the PAMM which requires prior approval if the program uses “more than \$10,000 of LSC funds to acquire an individual item of personal property...”

LSLA believed that the requirements of both 45 CFR 1630.5(b) (2) and Section 3(d) of the PAMM permitted these purchases. First, regulation 1630.5(b)(2) makes clear that prior LSC approval is required when “[p]urchases and leases of equipment, furniture, or other personal, non-expendable property, if the current purchase price of any individual item of property exceeds \$10,000.”

At the time that LSC published 1630.5, the preamble states:

“The \$10,000 threshold of subparagraph (b) (2) applies to individual items of personal property only. Corporation prior approval is no longer necessary for purchases and leases of individual items costing less than this amount, even if a purchase or lease of several related items with individual costs below \$10,000 has a combined cost which exceeds the threshold amount. However, the costs of acquiring such items must still meet the criteria of § 1630.3 of this part, including the requirement that such costs be reasonable and necessary to the performance of the grant or contract.” (See Vol. 62, No. 250, Federal Register, P. 68223 (December 31, 1997).

Similarly, section 3(d) of the PAMM requires prior approval when a recipient uses “...more than \$10,000 of LSC funds to acquire an individual item of personal property...” The preamble to section 3 states:

LSC received a number of comments on the various aspects of this section, several of which indicated a significant misunderstanding of the proposed requirements. Specifically, several commenters objected to what they took to be LSC’s proposal to require prior approval of aggregate acquisitions of over \$10,000. However, LSC did not propose to require prior approval of aggregate acquisitions of over \$10,000, but rather, only to require certain minimum competition standards for such large acquisitions. Under both the proposed and this final PAMM, prior approval is required, as specified in 45 CFR part 1630, for individual item acquisitions of over \$10,000, but not for aggregate acquisitions of over \$10,000.” (See Vol. 66, No. 178, Federal Register, p. 47691 (Sept. 13, 2001).)

The prior approval requirements found in 1630.5(b) (2) and section 3(d) of the PAMM apply only to an “individual item” of property and “not for aggregate acquisitions of over \$10,000.”

The OIG relies on the definition of “acquisition” in section 2(a) of the PAMM to overrule the specific “individual item” of property language in the prior approval sections of both 1630.5(b) (2) and section 3(d) of the PAMM. The word “acquisition” is not used at all in 1630.5(b) (2) which uses “purchases and leases” language. Similarly, while “acquisition” is mentioned 43 times in the PAMM, the very section that contains the prior LSC approval requirement section 3(d) of the PAMM does not use “acquisition” although it does state “to acquire an individual item of personal property.” But to read the word “acquire” to mean it applies to more than an individual item of personal property would be to entirely ignore the “individual item” language in the same sentence. The definition of “acquisition” in section 2(a) of the PAMM cannot be read to overrule the specific language on prior approval found in 1630.5(b) (2) and section 3(d) of the PAMM. Further, the clear distinction between “acquisition” and “individual item” was noted in the preamble to the PAMM. “[T]he term “single acquisition” includes transactions in which more than one item is procured in a single contract, while “individual item” does not.” See Vol. 66, No. 178, Federal Register, p. 47690 (Thursday, September 13, 2001).

Under this language, LSC grantees could purchase an individual item of personal property for less than \$10,000 and charge it to LSC funds (assuming the requirements of 1630.3 are met) without obtaining LSC’s prior approval. Grantees can also purchase or lease several related items with individual costs less than \$10,000 but whose combined cost exceed \$10,000, without LSC’s approval.

In addition, PAMM Section 2(g), *Property*, states:

“Property means any real or personal property having a market value greater than \$5,000, and a useful life of more than one year.”

PAMM does not address maintenance agreements, nor does the PAMM provide guidance on how to treat maintenance agreements that are for a single year or less. However,

we do know that since the maintenance agreements here had a useful life of one year or less, that the purchased maintenance agreements are not considered property as defined by the PAMM.

LSLA asks that the OIG reconsider these purchases as questioned costs because they were aggregate purchases involving less than \$10,000 per individual item permissible under reasonable and past interpretations of PAMM and 45 CFR 1630. Further, maintenance agreements with a life of one year or less are not property under PAMM. PAMM and 45 CFR 1630 both lack clarity regarding purchases of this nature and amount, and create uncertainty for LSC programs which should be a consideration in determining questioned costs.

Recommendation 8: The Executor Director should enforce policies and procedures that require disbursements to be accompanied by adequate supporting documentation before payment.

Response: The Executive Director has instructed the CFO to enforce policies and procedures that require disbursement to be accompanied by adequate supporting documentation before payment.

LSLA reviewed the OIG report disbursements valued at \$4,398 that did not have supporting documentation, and was able to locate supporting documents for a number of them. Report sent separately. LSLA asks that the OIG review this report as it should reduce the amount of questioned cost. Some supporting documents related to these purchases were in the Hurricane Ike recovery time period which hit the LSLA service area.

Recommendation 9: The Executive Director should ensure that staff is aware which expenses are considered allowable and unallowable under LSC funding.

Response: The Executive Director has reviewed allowable and unallowable expenses with the CFO and has instructed the CFO to review and be aware which expenses are considered allowable and unallowable under LSC funding with all staff connected with purchasing.

LSLA reviewed the sixteen (16) instances totaling \$2,481 that the OIG report listed as unallowable using LSC funds. LSLA concluded that staff mistakenly miscoded them to LSC.

APPENDIX II

Supplemental Grantee Management Information

In addition to the formal grantee management comments, the OIG was provided with additional supplemental information. This information was reviewed and evaluated. The results of the OIG's evaluation were included in the final audit report and resulted in reducing the amount of questioned costs contained in the draft. In addition, the OIG was able to close some recommendations based on this additional information. The supplemental information included invoices, inventory records, documents, and three resolutions passed by the grantee's Board of Directors. The resolutions provided specifically addressed the OIG's recommendations. The recommendations were entitled.

- RESOLUTION NO. 194 -- Lone Star Legal Aid Policy Regarding Internal Control Structure and Segregation of Duties
- RESOLUTION NO. 195 -- Lone Star Legal Aid Cost Allocation Methodology Policy, and
- RESOLUTION NO. 196 -- Lone Star Legal Aid Purchasing Policy.

Because of the volume of documents provided, the supplemental information is not included in its entirety in the final report.