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Legal Services Corporation

Inspector General
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September 27, 2010

James A. Wayne, Sr.
Executive Director
Capital Area Legal Services Corporation
200 Third Street
Baton Rouge, LA 70801

Dear Mr. Wayne:

Enclosed is the Office of Inspector General's (OIG) final report of our audit on Selected Internal Controls at Capital Area Legal Services Corporation. The OIG has reviewed your comments on the findings and recommendations contained in a draft of this report and made the following determinations.

Your comments described planned corrective actions that are responsive to the following 11 recommendations: 1, 2, 3, 4, 7, 8, 9, 10, 11, 17, and 18. These recommendations will remain open pending your notification to LSC management that the actions have been taken.

Your comments were not responsive to the following 10 recommendations: 5, 6, 12, 13, 14, 15, 16, 19, 20, and 21. These recommendations will be forwarded, along with the associated questioned costs, to LSC management for action.

We thank you and your staff for the cooperation and assistance you provided us.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

CAPITAL AREA LEGAL SERVICES CORPORATION

RNO 619010

Report No. AU-10-04

September 2010

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EXECUTIVE SUMMARY

Audit Process: This audit is a result of assistance provided by the Office of Inspector General (OIG) Office of Audit (OA) to support an OIG investigation of certain allegations at Capital Area Legal Services Corporation (CALSC or grantee). In connection with this assistance, OA conducted a limited-scoped audit of CALSC's disbursements and its accounting treatment of certain transactions and the related internal controls.

Results In Brief: CALSC needs to make significant improvements in its processes to ensure that costs are allowable and properly supported and that transactions are correctly recorded. As a result of CALSC's failure to ensure that costs were allowed and properly supported, the OIG is questioning a total of $318,768 in costs charged to LSC funds; these questioned costs will be referred to LSC management for review.

First, CALSC did not maintain adequate supporting documentation for expenditures charged to LSC funds totaling $238,190. These expenditures included $11,462 for the Executive Director's meals, $78,555 for the Executive Director's leased vehicle and gasoline, $3,527 for travel and related costs, and $144,646 for consultants.

Second, the method to allocate costs to LSC funds was not fully documented in CALSC's Financial Manual which limited the OIG's ability to make a definitive determination of the allowability of charges to LSC. Notwithstanding this limitation, the OIG identified $80,578 in transactions that were improperly charged to LSC. These transactions dealt with rental charges to LSC funds for a building that CALSC owns, and an insurance reimbursement for auto repair which was not credited to LSC funds even though the repair was initially paid with LSC funds. CALSC appears to have also improperly recorded transactions dealing with fringe benefits for leased vehicles used for personal travel, membership dues, lease payments, subscriptions, and client trust fund interest. CALSC may be liable for additional payments to the Internal Revenue Service and may be subject to sanctions from the State of Louisiana for not properly reporting fringe benefits and not properly handling client trust funds.

Recommendations:

The OIG made 21 recommendations to strengthen the internal controls over CALSC operations. These included recommendations to CALSC management to:

- revise the CALSC Financial Manual to require adequate documentation to support acceptable charges to LSC funds and provide explicit descriptions of the documentation required and ensure the manual is followed;

- ensure that all meals purchased with LSC funds have the business reason fully and contemporaneously documented;

- obtain LSC approval for all vehicle leases $10,000 or more and ensure that proper vehicle use records are maintained so that no costs associated with personal use of the vehicle are charged to LSC funds;

- ensure that consulting contracts contain a clear and complete description of the services to be performed and that all items required by the contract are received and meet contract requirements;

- develop, fully document, and implement a cost allocation method that meets LSC requirements;

- ensure that supporting documentation and explanations for the year-end accounting adjustments are maintained and in accordance with the allocation system;

- ensure that LSC funds are not charged rent for use of the Gonzales space and that if LSC funds are to be used to pay for the Gonzales space that formal approval from LSC be obtained and that LSC interest in the building be officially recorded;

- identify CALSC expenditures for vehicles and meals that were not adequately documented as business expenses and, to the extent not reimbursed by the employee for whom they were made, record the expenses as fringe benefits and report the fringe benefits to IRS; and

- establish procedures to ensure that: interest on client trust funds is properly recorded and transferred to the State Bar's Interest On Lawyers' Trust Account (IOLTA) program; appropriate reports are filed with the Louisiana Department of the Treasury with respect to client trust funds that have been unclaimed for a period of over 5 years; and procedures are established to regularly review client trust fund accounts to identify funds that have been held for more than 5 years.

  Summary of Grantee Comments: CALSC accepts the OIG recommendation to make significant improvements in its processes to ensure that costs are allowable and properly supported and that transactions are correctly recorded. CALSC further indicated that it will work with its accountant, independent auditor and Board of Directors to ensure that proper accounting practices are continued and/or implemented. However, CALSC disagreed with the finding that expenditures have not been properly documented and/or supported or that expenditures were improperly charged to LSC funds. CALSC's comments on individual recommendations are included in the body of the report and the full text of CALSC's comments is included in Appendix II.

OIG Evaluation of Grantee Comments: Although management's overall comments indicated that CALSC disagrees that expenditures have not been properly documented and/or supported or that expenditures were improperly charged to LSC funds, grantee management provided no documentation supporting its position. Consequently, the OIG will refer $318,768 of questioned costs to LSC management for review in accordance with 45 C.F.R. § 1630.7.

The OIG's evaluation of CALSC's specific comments on the 21 recommendations is included in the body of the report and summarized below:

The OIG considers CALSC's comments to be responsive to 11 recommendations in the following areas:

- Revising the CALSC Financial Manual to require adequate documentation.
- Strengthening internal controls to ensure compliance with the CALSC Financial Manual.
- Obtaining approvals for leases.
- Developing and maintaining an acceptable cost allocation system.
- Consistently recording transactions.

The OIG considers CALSC's comments to be non-responsive to 10 recommendations pertaining to the areas listed below and these will be referred to LSC for follow up action:

- Establishing controls over the use of vehicles.
- Charging itself rent for a building owned by CALSC.
- Establishing controls over client trust funds.
- Recording and IRS-reporting of fringe benefits.

The OIG considers all recommendations open until provided written notification that all actions have been completed.

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INTRODUCTION

This audit is a result of assistance provided by the Office of Inspector General (OIG) Office of Audit (OA) to support an OIG investigation of certain allegations at Capital Area Legal Services Corporation (CALSC or grantee). In connection with this assistance, OA conducted a limited-scoped audit of CALSC's disbursements and its accounting treatment of certain transactions and the related internal controls.

BACKGROUND

CALSC is a nonprofit organization created in 1958. Prior to 1974, CALSC was known as the Legal Aid Society. CALSC provides legal assistance to 12 parishes in the State of Louisiana and is funded primarily by LSC. According to LSC's data for calendar year 2009, CALSC received $1,511,082 from LSC.

OBJECTIVE, SCOPE AND METHODOLOGY

The objectives of the OIG's audit were to (1) assess whether selected expenditures[1] were properly charged to LSC funds, and (2) determine whether certain transactions were properly recorded in CALSC's accounting records. The OIG also assessed specific internal controls dealing with issues identified. The audit was limited in scope and was not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations or internal controls over compliance with LSC regulations.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, the OIG reviewed disbursements from employee and vendor files. The OIG reviewed invoices, contracts, check vouchers, and payments to vendors including restaurants and membership clubs. The appropriateness of grantee expenditures was assessed, based on the grant agreements, applicable laws and regulations, LSC policy guidance, and CALSC's policies and procedures. To test transactions, the OIG traced the associated transaction to check payments and to entries in the grantee's journals and general ledgers.

Grantee officials, board members and staff were interviewed as to their knowledge and understanding of the processes in place related to disbursements and accounting issues identified in our review. CALSC's current and former independent public accountants (IPAs) were also interviewed, and information

[1] The expenditures reviewed were directly related to an OIG investigation.

was obtained from the IPAs regarding CALSC's audit reports and internal processes.

Fieldwork was conducted at the grantee's central administrative office located in Baton Rouge, Louisiana from June 22 through July 1, 2009 and at headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2005 through May 31, 2009. For vehicle leases and the Gonzales building purchase, the OIG reviewed applicable documents pertaining to the period January 2000 through May 2009. 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. The OIG also relied upon the computer generated financial records when assessing whether financial transactions were properly recorded in the financial records. The general and application controls over the computer system were not tested.

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 audit 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.

Scope Limitation

During the audit, the OIG was not provided with post-closing general ledgers reflecting all audit adjustments nor supporting documentation for adjustments made by the IPA. CALSC's officials stated that they did not have a final version of some of the general ledgers and that the information would have to be obtained from their auditors. CALSC's former and current auditor prepared numerous journal entries at year end to adjust general ledger accounts. Along with correcting the account balances, these entries moved expenditures between LSC and non-LSC funds. Not being able to review the final general ledgers and supporting documentation for the adjustments prevented the OIG from being able to perform a complete analysis of CALSC's financial transactions and recorded expenditures. As a result, the OIG conducted the audit based on the documentation that was provided by CALSC and the pre-closing general ledgers, which did not include the independent auditor's adjustments.

The documents and financial records that were used to perform this audit gave the OIG some assurance about the nature of CALSC's transactions during the audit period, but not complete assurance. The OIG could not definitively determine which expenditures were charged to LSC funds and whether those expenditures were made in accordance with LSC regulations.

OVERALL EVALUATION

CALSC needs to make significant improvements in its processes to ensure that costs are allowable and properly supported and that transactions are correctly recorded. As a result of CALSC's failure to ensure that costs were allowed and properly supported, the OIG is questioning a total of $318,768 in costs charged to LSC funds.

First, CALSC did not maintain adequate supporting documentation for expenditures charged to LSC funds totaling $238,190. These expenditures included $11,462 for the Executive Director's meals, $78,555 for the Executive Director's leased vehicle and gasoline, $3,527 for travel and related costs, and $144,646 for consultants. The OIG is questioning the $238,190 of inadequately supported expenditures and will forward the questioned costs to LSC management for action.

Second, the method to allocate costs to LSC funds was not fully documented in CALSC's Financial Manual which limited the OIG's ability to make a definitive determination of the allowability of charges to LSC. Notwithstanding this limitation, the OIG identified $80,578 in transactions that were improperly charged to LSC. These transactions dealt with rental charges to LSC funds for a building that CALSC owns, and an insurance reimbursement for auto repair which was not credited to LSC funds even though the repair was initially paid with LSC funds. The OIG is questioning the $80,578 in improper charges and will forward the questioned costs to LSC management for action. CALSC appears to have also improperly recorded transactions dealing with fringe benefits, membership dues, lease payments, subscriptions, and client trust fund interest and may be liable for additional payments to the Internal Revenue Service and may be subject to sanctions from the State of Louisiana.

AUDIT FINDINGS

I. Expenditures Not Adequately Documented

CALSC made expenditures using LSC funds totaling $238,190 that were not supported by adequate documentation. These expenditures pertained to the following categories: meals and entertainment expense; leased vehicle and gasoline expense; travel and other expense; and consultant contract expense. This condition occurred because CALSC did not have effective internal controls to ensure compliance with its Financial Manual. Also, CALSC did not include in its Financial Manual sufficient information as to what documentation was required to support expenditures.

LSC regulation 45 C.F.R. § 1630.3 ("Standards governing allowability of costs under Corporation grants or contracts"), states that expenditures by a recipient are allowable under the recipient's grant or contract only if the recipient can demonstrate that the cost has met nine requirements. Among other things, these requirements state that the recipient must demonstrate that the cost was actually incurred in the performance of the grant, was reasonable and necessary for the performance of the grant, and was adequately and contemporaneously documented in business records. (See Appendix I for a complete list of the nine requirements and the definition of a reasonable cost.)

For the items addressed in the following sections, CALSC did not maintain adequate, contemporaneous documentation to demonstrate that the costs were reasonable and, therefore, allowable.

Meals and Entertainment Expenses

The OIG identified $11,462 of inadequately supported CALSC payments for the Executive Director's meals.[2] Of the amount, $8,953 was clearly charged to LSC funds and a portion of the remaining $2,509 was also charged to LSC funds (records did not clearly show the apportionment between LSC funds and non-LSC funds). The Executive Director frequently dined (breakfast, lunch, and dinner) at a private business club and restaurants in Baton Rouge. Invoices, meal tickets, receipts and statements from these establishments were sent directly to the CALSC accounting department for payment. Purpose of the meal and names of guests were added on some of the receipts and statements after

[2] The OIG's review of CALSC's general ledgers revealed that a total of $33,150 was expended for meals and entertainment during the audit period. Of the amount recorded in the general ledgers, $19,262 was charged to LSC funds and $13,888 was charged to non-LSC funds. We reviewed documentation (check vouchers, receipts, and vendors' invoices or billing statements) for meals totaling $22,876 (charged to both LSC and non-LSC funds). Of that amount, we identified $11,462 of inadequately supported payments for the Executive Director's meals.

the fact by the Executive Director, typically more than a month later. However, the specific LSC grant-related business purposes of the meals were not included in the supporting documentation. Many of the meals were lunches and dinners where the Executive Director dined alone, and some meals took place on weekends.

CALSC indicated that it used the current payment process because it did not have a credit card. As a result, the Executive Director converted his personal restaurant accounts to CALSC accounts, allowing his meal charges to be directly billed to CALSC. The Executive Director indicated that he instructed the accounting department not to pay the bills until he identified those charges that were business expenses. Accounting personnel stated that, in practice, when the Executive Director does not identify those business charges timely, they make a judgment call on what they deem to be business related, pay the bill, and then deduct any meal expenses determined to be personal from the Executive Director’s paycheck through a payroll deduction.

The CALSC payment practice does not comply with its own financial manual and does not provide adequate internal control over the allowability of meals and entertainment expenses. Personal expenses are being inappropriately charged to the grantee and decisions on allowability of the charges are being made after the fact rather than on contemporaneous supporting documentation.

The OIG provided CALSC a detailed listing of the inadequately supported meal expenses. CALSC did not identify any on the list as having been deducted from the Executive Director’s paycheck through a payroll deduction. Although the Executive Director provided a notarized statement that, to the best of his knowledge, all meals during the period whether charged to LSC or non-LSC funds were for official business, such a statement is insufficient. Business expenses should be adequately and contemporaneously documented.

Because the payments were not fully supported, the OIG is questioning the $11,462 for meals and will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7.

Leased Vehicle and Gasoline Expenses

For the period January 2005 through May 2009, CALSC charged LSC funds $78,555 for expenses associated with a CALSC leased vehicle used by the Executive Director. The Executive Director used the vehicle for both business and personal use without prior approval from LSC and without adequate documentation identifying when the vehicle was used for business and when the vehicle was used for personal reasons. Also, the Executive Director did not maintain and provide CALSC any records to document the use of the vehicle as required by the Internal Revenue Service (IRS). Lacking adequate records, CALSC did not report to IRS as required the value of all use of the vehicle by the Executive Director as wages.[3]

In February 2000, CALSC submitted to LSC a request to lease two vehicles, one of which was primarily for the Executive Director's use. LSC regulation 45 C.F.R. § 1630.5(b)(2) ("Costs requiring Corporation prior approval") requires prior approval of "[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."

The original request to LSC for the leases did not disclose that the vehicles would be used for both business and personal use. The original request indicated that the vehicles were to be used for business purposes and were going to be available for all staff to use. LSC officials requested additional information which CALSC supplied and the request was approved for a period of one year.[4] A follow-up request from CALSC to continue leasing the vehicles for an additional two years was approved by LSC in April 2001. CALSC did not submit requests for approval after the April 2001 approval expired in 2003. According to CALSC officials, even though the current vehicle leases were not approved, the leases have the same general leasing terms and the justification submitted for the original leases has not changed. LSC regulations do not make exceptions to obtaining prior approval.

The vehicle leasing expenses charged to LSC funds included $56,442 for vehicle lease payments and $4,233 for the related down payment on the vehicle. Gasoline expenses of $24,088 were charged to LSC funds. The Executive Director reimbursed $6,208 of the gasoline charges as being related to his personal use of the leased vehicle. Since trip logs were not maintained, the OIG could not determine if an appropriate amount was reimbursed by the Executive Director for gas. The Executive Director did not make any reimbursement for the cost of the lease or the related down payment for his personal use of the vehicle and trip logs were not maintained documenting the business versus personal use of the vehicle.

CALSC officials stated that "usage of trip logs was negated by the fact that the vehicle for the Executive Director was going to be used primarily by the Executive Director and the majority of the trips would be for LSC business purposes." Regardless of whether a majority of the trips were to be for business purposes, records were not maintained to ensure that LSC funds were not used for personal expenses and to meet IRS requirements.

[3] See page 12 of this report on issues related to reporting employee taxable fringe benefits to IRS.
[4] LSC's final approval document referenced the request for additional information and acknowledged the receipt of the requested information. However, because of the age of the documents, dated March 14, 2000, and April 19, 2000, LSC management was unable to locate the two documents.

Because the payments were not properly approved by LSC and not fully supported, the OIG is questioning the $56,442 in lease payments for the Executive Director's vehicle[5], $4,233 for the related down payment on the vehicle, and $17,880 for gasoline expenses. These questioned costs will be referred to LSC for review in accordance with 45 C.F.R. § 1630.7.

Travel and Other Expenses

Inadequately supported travel expenses were charged to LSC funds. These charges amounted to $3,273 and were for hotel, car rental, and airport parking expenses. An unsupported expense of $254 was also charged to LSC for a mirror for the Executive Director's leased vehicle.

Examples of inadequately supported expenses included charges to a CALSC debit card with only a bank statement showing the amount charged attached as support. Also, for some of the travel disbursements, CALSC only had an unapproved expense statement as support, with an inadequate description of the trip purpose and no invoices or receipts attached for gas, parking or other miscellaneous expenses. For these types of expenses, an approved invoice or receipt showing a description of the good or service, the price, date, and vendor would ordinarily be needed to support the expense, so as to document the amount of the charge and that it was an allowable charge to the LSC grant.

Because the payments were not adequately supported, the OIG is questioning $3,527 for the travel expenses and the mirror purchase, and will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7.

Consultant Contract Expenses

During the audit period, CALSC paid consultants $164,679 for fundraising activities of which $144,646 was charged to LSC funds and $20,033 was charged to non-LSC funds. The contract expenses were not adequately supported. The contracts did not clearly describe the deliverables. The contracts did require that action plans be submitted to CALSC concerning strategies for fundraising, but according to CALSC officials, such plans were not submitted. Invoices included the number of hours claimed to have been worked by the consultants for "fundraising services" but did not include a description of these services or when they were performed.

While CALSC provided minutes of Board meetings during which the Executive Director made positive comments about the consultants' fundraising efforts, CALSC did not provide adequate documentation related to the actual services

[5] The cost for second leased vehicle was not charged to LSC according to CALSC's records and therefore the cost is not questioned.

performed. Good business practices dictate that consultant contracts clearly spell out the services to be performed and the requirements for the consultant to provide reports related to those services. In the absence of documentation supporting the services provided by the consultants, the grantee cannot determine whether the charge is reasonable under the contract. Without this documentation, the OIG could not assess the reasonableness of the consultant charges.

Because the expenditures were not properly supported, the OIG is questioning the $144,646 for consulting contracting services and will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7.

Recommendations – The CALSC Executive Director should:

Recommendation 1. Revise the CALSC Financial Manual to require adequate documentation to support acceptable charges to LSC funds and provide explicit descriptions of the documentation required.

Recommendation 2**.** Strengthen internal controls to ensure compliance with the CALSC Financial Manual.

Grantee Management Comments

CALSC's Financial Manual is being revised and will be presented to CALSC's Board for review in October 2010 and submitted for final approval at the Board's January 2011 meeting. The revised Financial Manual will require adequate documentation to support acceptable charges to LSC Funds and will include a description of the documentation required. The manual will also require that documentation related to expenditures demonstrate that the cost was actually incurred in the performance of the grant, was reasonably necessary to the performance of the grant, and was adequately and contemporaneously documented in business records. It will require CALSC to meet all of the requirements set out in 45 CFR 1630.3. CALSC will institute steps to ensure that the Financial Manual is followed and that any other requirements as stated by LSC, OIG, CALSC's IPA, accountant and Board of Directors are implemented and followed. In the interim, the recommendations of CALSC's IPA and the OIG will be followed.

Though it is implementing these recommendations, CALSC maintains that it has provided evidence that the expenditures reviewed by the OIG meet the criteria set out in 45 CSR [sic] §1630.3

OIG Evaluation of Grantee Management Comments

CALSC's planned actions are responsive to the recommendations. However, Recommendations 1 and 2 will remain open until CALSC's Financial Manual has been revised, approved by the CALSC Board of Directors of Directors, and implemented.

The OIG disagrees with CALSC's comments that it has provided evidence that the expenditures reviewed by the OIG meet the criteria set out in 45 C.F.R. § 1630.3. CALSC did not provide adequate supporting documentation during the audit and has provided no additional supporting documentation in response to the draft report. The OIG will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7.

Recommendation 3. Limit expenditures for meals purchased with LSC funds to those with a legitimate purpose related to the grant. All meals purchased with LSC funds should have the business reason fully and contemporaneously documented to show that the expenditure was reasonable and necessary for the performance of the grant.

Grantee Management Comments

As described in CALSC's responses to the OIG's Request for Information regarding meals and entertainment expenses, it was CALSC's practice to reimburse James Wayne, Executive Director, for meal and entertainment expenses related to CALSC business. This was effectuated in some cases by direct submission of invoices from the vendor to CALSC's accounting department. Mr. Wayne then presented documentation for those items which were business related. Expenditures identified as personal expenses were either paid by Mr. Wayne or those expenditures were deducted from his payroll check in order to reimburse CALSC.

This practice has been changed. Modifications to CALSC's Financial Manual will include changes regarding meal and entertainment expenses. These changes will require CALSC employees to submit requests for reimbursement for any business-related expense. There will no longer be any direct charges to CALSC for this activity. Additionally, CALSC will implement better internal controls to determine the allowability of meals and entertainment expenses contemporaneous with receipt of supporting documentation. CALSC will ensure that all meals and entertainment expenditures using LSC funds are for business reasons and that those reasons are fully and contemporaneously documented. Appropriate controls for use of the CALSC corporate VISA/Debit Card will also be described in the Financial Manual.

OIG Evaluation of Grantee Management Comments

CALSC's planned actions are responsive to the recommendation. However, Recommendation 3 will remain open until CALSC's Financial Manual has been revised, approved by the CALSC Board of Directors, and implemented.

Recommendation 4. Obtain LSC approval for all vehicle leases as required by 45 CFR § 1630.5.

Recommendation 5. Ensure that vehicle users maintain records adequately documenting the business use of all vehicles. If personal use is permitted, maintain records adequately documenting such use.

Recommendation 6. If leased vehicles funded with LSC funds be approved for personal use, establish controls to ensure that the grantee is reimbursed for vehicle expenses for all personal use including lease payments, gasoline, insurance, and repairs and maintenance, and that the reimbursement is credited to the grantee's LSC funds.

Grantee Management Comments

If CALSC enters into a lease that requires LSC approval, CALSC will obtain that approval. It has revised its vehicle use policy and that policy is attached to this response. This policy has been implemented to address the recommendation of the OIG.

CALSC will ensure that proper vehicle use records are maintained so that no cost associated with personal use of the vehicle are charged to LSC funds. It should be noted that neither of the present leased vehicles cost more than $10,000 per year during the leased period.

CALSC submits that it has provided documentation for expenditures related to the leased vehicles.

OIG Evaluation of Grantee Management Comments

CALSC's planned actions are partially responsive. CALSC agreed to obtain approval for any lease that requires LSC approval (Recommendation 4). The CALSC response also stated that neither of the present leased vehicles cost more than $10,000 per year during the leased period. However, this is not the criteria for obtaining prior approval stated in 45 CFR § 1630.5. Rather, in accordance with that section, CALSC should have obtained prior approval of the leases from LSC.

CALSC submitted a revised vehicle use policy that does not ensure that (1) all vehicle users, including the Executive Director, maintain records adequately documenting the business and personal use of vehicles and (2) the grantee is reimbursed for vehicle expenses for all personal use including lease payments, gasoline, insurance, and repairs and maintenance, and the reimbursement is credited to the grantee's LSC funds (Recommendations 5 and 6).

The OIG disagrees with CALSC's comments that it has provided documentation for expenditures related to leased vehicles. The CALSC response provided no additional supporting documentation. The OIG will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7. In addition, Recommendations 4, 5, and 6 will be referred to LSC for follow-up action.

Recommendation 7. Ensure that all bank card charges are supported with an original receipt and that the business purpose of each charge is fully and contemporaneously documented.

Grantee Management Comments

CALSC's Financial Manual will be revised to address this recommendation.

OIG Evaluation of Grantee Management Comments

CALSC's planned actions are responsive to the recommendation. However, Recommendation 7 will remain open until CALSC's Financial Manual has been revised, approved by the CALSC Board of Directors, and implemented.

Recommendation 8. Ensure that consulting contracts contain a clear and complete description of the services to be performed and a requirement that the consultant provide detailed reports for the services provided.

Recommendation 9**.** Require that invoices for consultant contracts contain a detailed description of the work performed, not just a record of the hours expended. In addition, ensure that all items required by the contract are received and meet contract requirements.

Grantee Management Comments

The purpose of all consultant contracts will be adequately supported. Any such contracts will clearly describe the deliverables, require an action plan, require description of the services performed, and provide adequate contemporaneous documentation related to the actual services performed. The contracts will also require that the consultants provide reports related to their services. CALSC will implement procedures to ensure that all items required by the contract are received and meet the contract requirements.

CALSC will require that all contracts meet the requirements recommended in the 2010 Edition of the Accounting Guide for LSC recipients. This will also be included in CALSC's Financial Manual.

CALSC maintains that it has submitted justification for the payments made to consultants and reviewed by OIG and that those payments were reasonable. Therefore, these expenditures were properly incurred and charged to LSC funds.

OIG Evaluation of Grantee Management Comments

CALSC's planned actions are responsive to the recommendations. However, Recommendations 8 and 9 will remain open until CALSC's Financial Manual has been revised, approved by the CALSC Board of Directors, and implemented.

The OIG disagrees with CALSC's comments that it has provided adequate justification for the payments made to consultants and that the payments were reasonable. The justification provided during the audit and reviewed by the OIG was not adequate to support the payments made. CALSC provided no additional supporting documentation in response to the draft report. The OIG will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7.

II. <u>Transactions Not Properly Recorded</u>

CALSC did not have an adequately documented cost allocation system and did not properly record certain transactions in its books and records. The transactions dealt with the following and are explained below:

- Rent for the Gonzales building
- An auto repair reimbursement
- Fringe Benefits
- Membership dues, lease payments, and subscriptions
- Client trust fund interest

These conditions occurred was because (1) CALSC did not have sufficiently detailed policies and procedures that addressed the proper handling of the transactions identified by the OIG, and (2) CALSC did not have corresponding internal controls in place to ensure that the CALSC policies and procedures were followed. As a result, the OIG is questioning $80,578 in charges made to LSC funds.

Cost Allocation System

The current cost allocation system was not fully documented in CALSC's Financial Manual and CALSC could not provide an accurate description of the allocation process while we were on site. LSC's rules regarding allocations among funds are set forth in 45 C.F.R. Part 1630. When asked, CALSC's financial officials could not explain how the system operated or how specific costs were allocated. As a result, the OIG could not determine whether adequate internal controls were in place or how certain expenditures were ultimately allocated among the various funding sources, including LSC.

CALSC's current and former IPAs customarily proposed a large number of year-end adjustments to the grantee's accounting records, which include reclassifying certain expenditures to different accounts and sub-accounts within the accounting system. When asked about the nature of the adjustments, CALSC's management could not provide or explain the adjustments. Nor did CALSC's management maintain documents supporting the adjustments. CALSC management referred the OIG to the IPA for all matters concerning audit adjustments. The grantee's lack of knowledge of the proposed audit adjustments to its books raised significant questions about the understanding of the composition of the accounts in the grantee's financial system. Adjusting journal entries proposed by IPAs must be accepted by management as its own. In order to accept those entries, management must have a thorough understanding of the adjustments and the effect on the accounts and financial statements.

The OIG contacted the IPA and was provided with a copy of the FY 2008 audit adjustments but not the supporting documentation. Our analysis revealed that there were adjustments made to 66 different accounts ranging from $9.00 to $503,940. This represented a large number of annual adjustments for an organization the size of CALSC and could indicate a significant weakness in its accounting function.

Adjusting entries to CALSC accounts proposed by the IPA at year end significantly changed how expenditures were originally allocated to funding sources. Some expenditures for meals, vehicles, and travel were initially directly charged to LSC funds and other expenditures were initially charged to non-LSC funds. However, due to the large number of adjustments, some of the charges to non-LSC funds may have been reallocated to LSC at year end, and some charges to LSC funds may have been reallocated to non-LSC funds. The OIG was unable to determine the impact of the reallocations because CALSC could not explain the nature of the audit adjustments and did not provide any documentation supporting the adjustments. Having adequate documentation of, or at a minimum, being able to explain allocations and reallocations is critical to determining exactly what was ultimately charged to LSC funds and whether those charges were in accordance with LSC regulations.

Rental of Gonzales Building Office Space

CALSC was charging rent to LSC funds for a building that CALSC owned. This practice creates an interest in the building for LSC and constitutes a questioned cost for the rent charges because they are not reasonable and necessary.

In FY 2001, CALSC purchased the Gonzales Building for $425,000 by borrowing $25,000 from the seller through a promissory note and obtaining a $400,000 loan from a local bank. CALSC did not request LSC approval for the purchase because CALSC claimed that LSC funds were not being used for the purchase. CALSC occupies office space in the building it purchased and pays itself rent in the amount of $750 per month. It then charges this rent to LSC funds. At $750 each month, CALSC has paid itself an estimated $9,000 per year for 8-½ years, amounting to approximately $76,500. (It should be noted that the exact amount charged to LSC funds each year is unclear because adjusting entries to the space accounts were made at year-end and the OIG was not furnished the support for these adjustments.)

CALSC contends that rent payments were appropriate and do not create an interest. CALSC stated that there is no difference between LSC paying rent for space in the Gonzales office, which CALSC now owns, and LSC paying rent for the Baton Rouge office, which CALSC does not own. CALSC also contends that since LSC funds were used to rent the same office space from the previous owner, CALSC would be entitled to rent from LSC funds after purchasing the building.

CALSC is a single entity and need not pay itself rent to occupy a building it already owns. As such, rent payments charged to LSC funds were not reasonable and necessary in our opinion and stripped down to economic essentials, the grantee's rent payments function as a mechanism for converting LSC funds to non-LSC funds that could be used to pay the mortgage on the Gonzales building, thus not recognizing LSC's interest in the property.

As a matter of economic reality, it appears that LSC funds are being used to finance the purchase of the Gonzales building. By charging LSC rent, CALSC obscures the LSC character of the funds used to purchase the building. Accordingly, we conclude that CALSC's payment of rent to itself with LSC funds for office space in a building that it owns likely creates an interest in an amount equal to the value of the rent paid. To the extent an interest exists, CALSC must first obtain the permission of LSC and/or compensate LSC for its interest in the property should CALSC wish to convert the property for other uses or sell the property in the future.

Even if the rent payments in question did not create an interest, they would amount to a questioned cost because it is not reasonable and necessary for a single entity to pay itself rent in order to occupy a building that it already owns. Unless and until CALSC establishes LSC's interest in an amount equal to the value of rent paid, the OIG questions the cost of all rent payments that CALSC made with LSC funds after it purchased the Gonzales building.

Because the rent payments were not reasonable and necessary, the OIG is questioning the $76,500 for rent payments and will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7.

Auto Repair Reimbursement

If LSC funds are used to pay for a good or service that is subsequently reimbursed, the reimbursement should be recorded as LSC revenue according to Section 2-2.7 of the accounting manual for LSC recipients and generally accepted accounting principle of matching income and expenses.

In December 2005, CALSC received a check for $4,077.77 from an insurance company related to repair work on a leased vehicle that was involved in an auto accident in November 2005. CALSC recorded the amount in a non-LSC miscellaneous income account. When the repair work was completed in January 2006, CALSC charged the cost of the repair to LSC funds rather than to the non-LSC funds that the insurance check was recorded against.

When informed of this situation, CALSC stated that the reimbursement was mistakenly recorded incorrectly and recognized that LSC funds were required to be reimbursed when the check was received.

As a result of the finding, the OIG is questioning the $4,077.77 charged to LSC funds for car repairs and will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7.

Fringe Benefits

Some CALSC expenditures (both LSC funded and non-LSC funded) may have been more properly characterized as personal employee expenses rather than CALSC business-related expenses. CALSC should have recorded these expenditures as fringe benefits to the employee and made the appropriate reporting to the employee and IRS in accordance with IRS regulations.

According to Internal Revenue Service guidance:

- A fringe benefit is a form of pay for the performance of services. For example, a fringe benefit is provided to an employee when the employee is allowed to use a business vehicle to commute to and from work. Any fringe benefit provided is taxable and must be included in the recipient's pay unless the law specifically excludes it. (IRS Publication 15-B)
- If an employer-provided vehicle is used for both business and personal purposes, substantiated business use is not taxable to the employee. Personal use is taxable to the employee as wages. However, if records are not provided by the employee, the value of all use of the automobile is wages to the employee, and the employee can then take itemized deductions for any substantiated business use on Form 1040, Schedule A. *Reg. §1.132-5(b).* (IRS Fringe Benefit Guide, Federal, State, and Local Governments)

- The employer should require the employee to maintain timely-kept records for meals and entertainment that detail the following elements:

  - The business purpose for the expense or the business benefit gained or expected to be gained.
  - Occupations or other information (such as names, titles, or other designations) about the recipients that shows the business relationship. (IRS Publication 463)

CALSC expenditures that were not adequately supported as business expenses are required to be treated as fringe benefits to the employee if the expense was personal in nature. Examples are described below:

- CALSC leases two vehicles which are authorized for both business and personal use. CALSC indicated that logs are not maintained by the employees assigned these vehicles to document the use of the vehicles and that the employees do not reimburse the program a proportionate share of the vehicle lease and other vehicle related costs attributable to the personal use. At least one of the individuals who used a leased vehicle reimbursed gasoline costs for personal use. However, without any documentation, CALSC had no way to determine if the amount reimbursed accurately reflected the personal use of the vehicle.
- CALSC made expenditures for meals provided to CALSC employees. However, for some expenditures in our sample, CALSC did not maintain adequate records showing the specific business purposes of the meals and entertainment.

Because the appropriate records were not maintained, the value of all use of the vehicles and the cost of some meals are required to be reported to IRS as wages to the employees.

CALSC may be subject to IRS sanctions because employee fringe benefits were not properly reported to the IRS. Classifying personal expenses as business expenses distorts the true cost of providing legal services to those in need and may reduce the funds available to provide service to clients.

Account Classification and Description

CALSC was not recording some expenditures in a consistent manner over time. In FY 2005, NLADA membership dues were recorded in the general ledger account for "Meetings" (account 7600) instead of Membership and Dues (account 5900)[6]. In FY 2006 through FY 2009, the dues were recorded initially as Prepaid Expense and then expensed during the year. In FY 2005 and FY 2006 subscriptions for NLADA publications were charged to the Library Maintenance account (5700), however, in FY 2007 through FY 2009 they were recorded in account 5900. CALSC also recorded vehicle lease payments under the Staff Travel Account instead of a lease or rent account.

CALSC indicated to the OIG that it has a process for reviewing coding errors and the hiring of additional staff will be helpful in this function. However, the process did not identify and correct these transactions.

Properly and consistently recording transactions helps ensure the accuracy of financial reports so that those charged with governance have accurate information to conduct oversight responsibilities.

[6] These NLADA membership dues were not charged to LSC funds.

Client Trust Fund Interest and Dormant Accounts

<u>Client Trust Fund Interest</u>

A review of CALSC's financial statements for FY 2008 and FY 2007 revealed that the Client Trust Fund asset account was approximately $4,000 greater than the related liability account. CALSC management indicated that the difference was due to interest that had been accumulating over the years on Client Trust Funds. CALSC recorded the interest as revenue to CALSC instead of as a payable to the State Bar Association.
Interest earned on Client Trust Funds should have been recorded as a liability rather than income and the funds submitted to the Louisiana Bar Association in accordance with Interest on Lawyers' Trust Account (IOLTA) provisions. As a result of the audit, CALSC provided the calculation of the interest earned and indicated that a check for $4,080.32 had been submitted on January 22, 2010 to the Louisiana Bar Foundation-IOLTA Project.

<u>Dormant Accounts</u>

While reviewing the Client Trust Fund interest issue, the OIG also noted that CALSC was not remitting dormant Client Trust Fund accounts to the State. CALSC's Client Trust Funds are made up of two bank accounts – one account (approximately $25,000) belonged to clients who had not redeemed their funds for over five years, many of whom had not redeemed their funds for over 20 years. The other account ($49,000) belonged to clients who are more current, some of whom had not redeemed their funds for over five years. Funds held in these accounts for more than five years should have been escheated to the Louisiana Department of the Treasury, Unclaimed Property Division.

The <u>Accounting Guide for LSC Recipients</u> informs grantees that "state escheat laws govern the disposition of unclaimed client trust funds." In Louisiana, the Uniform Unclaimed Property Act requires that unclaimed or abandoned property be paid over to the Department of the Treasury after a statutorily defined period. La. Rev. Stat. 9:152 *et seq*. With respect to the property of the sort held in the Client Trust Funds at issue, Louisiana law prescribes a 5-year period after which the funds are presumed abandoned. La. Rev. Stat. 9:154(A)(4) & (17). Consequently, much of the property held in the CALSC's Client Trust Funds is subject to escheatment. Willful failure to report and/or deliver abandoned property to the Department of the Treasury could subject the holder of the property to a penalty of up to $25,000 plus twenty-five percent of the value of any property. La. Rev. Stat. 9:176(C).

CALSC maintains that Rule 1.15 of the Louisiana Rules of Professional Conduct governs the Client Trust Funds in question and that it is aware or in possession of an order or letter from the Supreme Court of Louisiana effectively exempting dormant Client Trust Funds from the Uniform Unclaimed Property Act as adopted in Louisiana. The OIG requested that CALSC provide a copy of the material from the Supreme Court of Louisiana upon which CALSC purports to rely, but the material has not been provided. A review of publicly available authority revealed that, in 2006, the Louisiana State Bar Association issued a public opinion counseling lawyers that they "should review and consider the Uniform Unclaimed Property Act of 1997, [La. Rev. Stat.] 9:151, *et seq.*" after a reasonable effort to locate missing clients. Rules of Professional Conduct Committee, Public Opinion 06-RPCC-009. In 1993, the Attorney General of Louisiana informed CALSC that "[a]fter CALSC has held [client trust] funds for five (5) years, the funds are presumed abandoned and CALSC must comply with the requirements of the LUUPA [Louisiana Uniform Unclaimed Property Act] ...." Attorney General Opinion No. 93-133. The OIG brought the same issue to CALSC's attention in a May 2000 inspection report concerning Client Trust Funds. Report No. OIG 00-006. The OIG is not aware of any basis for disregarding the force of the Uniform Unclaimed Property Act as applied to the Client Trust funds in question and, given the protracted history of these funds, will refer the matter to the Louisiana Department of the Treasury.

Recommendations – The CALSC Executive Director should:

Recommendation 10. Develop, fully document, and implement a cost allocation method that meets LSC requirements.

Recommendation 11. Obtain and maintain in the CALSC books and records the supporting documentation and explanations for the year-end accounting adjustments and cost allocations for the past 5 years. Assess the impact of the adjustments and allocations on the allowability of costs charged to LSC for that period.

Grantee Management Comments

CALSC will insure that it has sufficiently detailed policies and procedures to address the proper handling of all transactions, including those identified by the OIG. Internal controls will be implemented (at the recommendation of CALSC's IPA, accountant, and Board of Directors) and submitted to the OIG for approval. Steps will be taken to fully document the cost allocation system in CALSC's Financial Manual.

CALSC will maintain documents supporting audit adjustments recommended by its IPA and will designate an employee to be responsible for review and implementation of any proposed audit adjustments. CALSC will work with its IPA to reduce the number of annual audit adjustments and to improve its accounting function. Adequate documentation will be maintained of all allocations and re-allocations. CALSC will seek input from its IPA, account [sic], Board of Directors, and LSC.

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

CALSC's planned actions are responsive to the recommendations. However, Recommendations 10 and 11 will remain open until CALSC has developed and implemented the detailed policies, procedures, and internal controls described in its response.

<u>Recommendation 12</u>. Ensure that LSC funds are not charged rent for use of the Gonzales space.

<u>Recommendation 13</u>. If CALSC wishes to use LSC funds in the future to help make mortgage payments on the Gonzales building loan, obtain formal approval from LSC and record LSC's interest in the property records for the building.

<u>Recommendation 14</u>. To the extent that rental costs are not recovered through the questioned cost process, formally establish LSC's interest in the Gonzales building for the remaining balance.

<u>Grantee Management Comments</u>

CALSC denies that anything improper has occurred in connection with rental charges for the Gonzales office space. CALSC disagrees with the OIG's findings related to this building. CALSC will seek further guidance from its IPA and LSC regarding this situation. This building was not purchased with LSC funds nor has LSC funds been used for its maintenance and operation. LSC was fully advised of CALSC's purchase of this building and was well aware that CALSC charges LSC a fair market value for this office space. The location is near the courthouse, clerk of court annex, sheriff office, social service office and serves as CALSC disaster operation center for storms and other emergencies. This office was purchased in 2001 and has been reviewed by LSC and OIG personnel in the past.

CALSC will seek LSC's formal approval to continue to charge rent to LSC for the use of this building and to establish that LSC has no interest in this property.

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

CALSC disagreed with the OIG's finding. Also, CALSC's planned actions are not responsive to the recommendations. While CALSC stated it will seek LSC's formal approval to continue to charge rent to LSC, it has not agreed to refund all previous rent charges to LSC or to formally establish LSC's interest in the building. CALSC claims that the purchase was reviewed in the past by LSC and OIG, but provides no information as to when the reviews were conducted, the reasons for the review, the information or representations provided by CALSC to the reviewers, or the results of the reviews. CALSC's practice of charging rent to LSC funds for a building that CALSC owned creates an interest in the building for LSC and constitutes a questioned cost for the rent charges because they are not reasonable and necessary. The OIG will refer the questioned costs to LSC for review in accordance with 45 C.F.R. § 1630.7. In addition Recommendations 12, 13, and 14 will be referred to LSC for follow up action.

Recommendation 15. Identify CALSC expenditures for vehicles and meals that were not adequately documented as business expenses and, to the extent not reimbursed by the employee for whom they were made, record the expenses as fringe benefits.

Recommendation 16. For expenses determined to be fringe benefits as described in Recommendation 15, file amended W-2 statements for CALSC employees impacted and amended corporate tax returns in accordance with IRS regulations.

Grantee Management Comments

CALSC has provided its records related to all expenditures for vehicle as well as of [sic] reimbursement for any personal expenses. It should be noted that CALSC has changed its method and procedure as to meals previously charged at various restaurants. When the corporation credit card is not available, the Executive Director (or any other CALSC employee) will pay the cost for business related charges and upon adequate documentation will be reimbursed for reasonable business expenditures.

If LSC funds are used to pay for goods or service and are subsequently reimbursed, the reimbursement will be recorded as LSC revenue as required by applicable guidelines and by the accounting manual for LSC recipients.

OIG Evaluation of Grantee Management Comments

CALSC's comments do not address the recommendations and are therefore not responsive. The OIG recommended that CALSC comply with the IRS regulations pertaining to employee fringe benefits. According to IRS guidance any fringe benefit is taxable and must be included in the recipient's pay unless the law specifically excludes it. If records are not provided by the employee, the value of all use of the automobile is wages to the employee. Since adequate records were not maintained, CALSC is required to report certain expense to IRS as wages. Failure to do so could result in monetary sanctions being imposed on

CALSC by IRS. CALSC has not described the specific steps it has taken to ensure that both business-related expenses and expenditures for employer-provided vehicles are properly recorded, maintained, and reported to the IRS when applicable. Recommendations 15 and 16 will be referred to LSC for follow up action.

Recommendation 17. Establish adequate review processes to ensure that posting errors are identified and corrected.

Recommendation 18. Establish adequate review processes to ensure that transactions are accorded consistent treatment over time.

Grantee Management Comments

CALSC's Financial Manual is being revised to provide procedures to ensure that posting errors are identified and corrected and that similar transactions are treated consistently.

OIG Evaluation of Grantee Management Comments

CALSC's planned actions are responsive to the recommendations. However, Recommendations 17 and 18 will remain open until CALSC's Financial Manual has been revised, approved by the CALSC Board of Directors, and implemented.

Recommendation 19. Establish procedures to ensure that interest on client trust funds is properly recorded and transferred to IOLTA in a timely manner.

Recommendation 20. Ensure that the appropriate reports are filed and payments made to the Louisiana Department of the Treasury with respect to Client Trust Funds that have been unclaimed for a period of over 5 years.

Recommendation 21. Establish procedures to (a) regularly review Client Trust Fund accounts to identify property that has been held for more than 5 years and (b) pay such property over to the Louisiana Department of the Treasury pursuant to the Uniform Unclaimed Property Act.

Grantee Management Comments

Steps have been taken to ensure that interest earned on client trust funds is properly recorded as a liability and that the funds are submitted to the Louisiana Bar Association in accordance with the Interest on Lawyers' Trust Account (IOLTA) provisions. CALSC will work with the Louisiana State Bar Association and the Louisiana Department of the Treasury to determine the proper disposition of these funds. Efforts will be made to locate the client-owners.

CALSC has corrected the error that occurred when it changed banks and the new bank did not automatically send the interest to IOLTA.

OIG Evaluation of Grantee Management Comments

CALSC's comments are not responsive to the recommendations. CALSC has not sufficiently described the steps it has taken or plans to take that will address the recommendations. While CALSC stated that steps have been taken to properly record interest earned on client trust funds, no information was provided as to what these steps were or if formal policies and procedures have or are being developed. In addition, CALSC did not respond to Recommendations 20 and 21. Recommendations 19, 20, and 21 will be referred to LSC for follow-up action.

APPENDIX I

Standards Governing Allowability of Costs Under Corporation Grants or Contracts

I. Allowability of Costs

45 C.F.R. § 1630.3 Standards governing allowability of costs under Corporation grants or contracts.

(a) *General criteria.* Expenditures by a recipient are allowable under the recipient's grant or contract only if the recipient can demonstrate that the cost was:

(1) Actually incurred in the performance of the grant or contract and the recipient was liable for payment;

(2) Reasonable and necessary for the performance of the grant or contract as approved by the Corporation;

(3) Allocable to the grant or contract;

(4) In compliance with the Act, applicable appropriations law, Corporation rules, regulations, guidelines, and instructions, the Accounting Guide for LSC Recipients, the terms and conditions of the grant or contract, and other applicable law;

(5) Consistent with accounting policies and procedures that apply uniformly to both Corporation-financed and other activities of the recipient;

(6) Accorded consistent treatment over time;

(7) Determined in accordance with generally accepted accounting principles;

(8) Not included as a cost or used to meet cost sharing or matching requirements of any other federally financed program, unless the agency whose funds are being matched determines in writing that Corporation funds may be used for federal matching purposes; and

(9) Adequately and contemporaneously documented in business records accessible during normal business hours to Corporation management, the Office of Inspector General, the General Accounting Office [Government Accountability Office] and independent auditors or other audit organizations authorized to conduct audits of recipients.

II. Reasonableness of Costs

45 C.F.R. § 1630.3 Standards governing allowability of costs under Corporation grants or contracts.

(b) *Reasonable costs.* A cost is reasonable if, 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. If a questioned cost is disallowed solely on the ground that it is excessive, only the amount that is larger than reasonable shall be disallowed. In determining the reasonableness of a given cost, consideration shall be given to:

(1) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the recipient or the performance of the grant or contract;

(2) The restraints or requirements imposed by such factors as generally accepted sound business practices, arms-length bargaining, Federal and State laws and regulations, and the terms and conditions of the grant or contract;

(3) Whether the recipient acted with prudence under the circumstances, considering its responsibilities to its clients and employees, the public at large, the Corporation, and the Federal government; and

(4) Significant deviations from the established practices of the recipient which may unjustifiably increase the grant or contract costs.

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August 23, 2010

VIA EMAIL AND U.S. MAIL
Mr. Ronald D. Merryman
Assistant Inspector General for Audit
Office of Inspector General
3333 K Street, NW, 3rd Floor
Washington, DC 20007-3558

Re: Capital Area Legal Services Corporation

Dear Mr. Merryman:

Please find enclosed Capital Area Legal Services Corporation's (CALSC) response to the draft report submitted to CALSC on Jun 24, 2010.

Thank you for your courtesies in allowing CALSC extra time to respond.

Sincerely,

Vicki M. Crochet

VMC/mm

Enclosure

545565.1

August 16, 2010

EXECUTIVE SUMMARY

The following is Capital Area Legal Services Corporation (CALSC's) response to the June 24, 2010 draft report of the Legal Services Corporation (LSC) Office of Inspector General (OIG):

Sometime in February 2009, LSC, Office of Inspector General (OIG), Office of Audit (OA) notified CALSC that it was conducting a financial and compliance audit of CALSC's operation. Since that time, the OIG has made several visits to CALSC and CALSC has produced documents and other information in response to numerous inquiries. CALSC Board Chair, Brent Hicks, has urged OIG investigators throughout the review to advise him of any irregularities or compliance issues. CALSC has now received the June 24, 2010 OIG draft report.

In the Executive Summary, OIG concludes that "CALSC needs to make significant improvements in its processes to insure that costs are allowable and properly supported and that transactions are correctly recorded." CALSC accepts this recommendation and as described in this response will work with its accountant, independent personal auditor (IPA) and Board of Directors to insure that proper accounting practices are continued and/or implemented. However, CALSC disagrees with the finding that expenditures have not been properly documented and/or supported or that expenditures were improperly charged to LSC.

CALSC submits the following in response to the OIG's itemized recommendations:

Recommendations 1 and 2:

1. **Revise the CALSC Financial Manual to require adequate documentation to support acceptable charges to LSC funds and provide explicit descriptions of the documentation required and ensure the manual is followed:**

2. **Strengthen internal controls to ensure compliance with the CALSC Financial Manual.**

Response:

CALSC's Financial Manual is being revised and will be presented to CALSC's Board for review in October 2010 and submitted for final approval at the Board's January 2011 meeting. The revised Financial Manual will require adequate documentation to support acceptable charges to LSC Funds and will include a description of the documentation required. The manual will also require that documentation related to expenditures demonstrate that the cost was actually incurred in the performance of the grant, was reasonably necessary to the performance of the grant, and was adequately and contemporaneously documented in business records. It will require CALSC to meet all of the requirements set out in 45 CFR 1630.3. CALSC will institute steps to ensure that the Financial Manual is followed and that any other requirements as stated by LSC, OIG, CALSC's IPA, accountant and Board of Directors are implemented and followed. In the interim, the recommendations of CALSC's IPA and the OIG will be followed.

Though it is implementing these recommendations, CALSC maintains that it has provided evidence that the expenditures reviewed by the OIG meet the criteria set out in 45 CSR §1630.3.

Recommendation 3:

3. **Limit expenditures for meals purchased with LSC funds to those with a legitimate purpose related to the grant. All meals purchased with LSC funds should have the business reason fully and contemporaneously documented to show that the expenditure was reasonable and necessary for the performance of the grant:**

Response:

As described in CALSC's responses to the OIG's Request for Information regarding meals and entertainment expenses, it was CALSC's practice to reimburse James Wayne, Executive Director, for meal and entertainment expenses related to CALSC business. This was effectuated in some cases by direct submission of invoices from the vendor to CALSC's accounting department. Mr. Wayne then presented documentation for those items which were business related. Expenditures identified as personal expenses were either paid by Mr. Wayne or those expenditures were deducted from his payroll check in order to reimburse CALSC.

This practice has been changed. Modifications to CALSC's Financial Manual will include changes regarding meal and entertainment expenses. These changes will require CALSC employees to submit requests for reimbursement for any business-related expense. There will no longer be any direct charges to CALSC for this activity. Additionally, CALSC will implement better internal controls to determine the allowability of meals and entertainment expenses contemporaneous with receipt of supporting documentation. CALSC will ensure that all meals and entertainment expenditures using LSC funds are for business reasons and that those reasons are fully and contemporaneously documented. Appropriate controls for use of the CALSC corporate VISA/Debit Card will also be described in the Financial Manual.

Recommendations 4, 5 and 6:

4. **Obtain LSC approval for all vehicle leases $10,000 or more:**

5. **Ensure that vehicle users maintain records adequately documenting the business use of all vehicles. If personal use is permitted, maintain records adequately documenting such use.**

6. **Should leased vehicles funded with LSC funds be approved for personal use, establish controls to ensure that the grantee is reimbursed for vehicle expenses for all personal use including lease payments, gasoline, insurance, and repairs and maintenance, and that the reimbursement is credited to the grantee's LSC funds.**

Response:

IF CALSC enters into a lease that requires LSC approval, CALSC will obtain that approval. It has revised its vehicle use policy and that policy is attached to this response. This policy has been implemented to address the recommendations of the OIG.

CALSC will ensure that proper vehicle use records are maintained so that no cost associated with personal use of the vehicle are charged to LSC funds. It should be noted that neither of the present leased vehicles cost more than $10,000 per year during the leased period.

CALSC submits that it has provided documentation for expenditures related to the leased vehicles.

Recommendation 7:

7. **Ensure that all bank card charges are supported with an original receipt and that the business purpose of each charge is fully and contemporaneously documented**:

Response:

CALSC's Financial Manual will be revised to address this recommendation.

Recommendations 8 and 9:

8. **Ensure that consulting contracts contain a clear and complete description of the services to be performed and a requirement that the consultant provide detailed reports for the services provided:**

9. **Require that invoices for consultant contracts contain a detailed description of the work performed, not just a record of the hours expended. In addition, ensure that all items required by the contract are received and meet contract requirements:**

Response:

The purpose of all consultant contracts will be adequately supported. Any such contracts will clearly describe the deliverables, require an action plan, require description of the services performed, and provide adequate contemporaneous documentation related to the actual services performed. The contracts will also require that the consultants provide reports related to their services. CALSC will implement procedures to ensure that all items required by the contract are received and meet the contract requirements.

CALSC will require that all contracts meet the requirements recommended in the 2010 Edition of the Accounting Guide for LSC recipients. This will also be included in CALSC's Financial Manual.

CALSC maintains that it has submitted justification for the payments made to consultants and reviewed by OIG and that those payments were reasonable. Therefore, these expenditures were properly incurred and charged to LSC funds.

Recommendations 10 & 11:

10. **Develop, fully document, and implement a cost allocation method that meets LSC requirements:**

11. **Obtain and maintain in the CALSC books and records the supporting documentation and explanations for the year-end accounting adjustments and cost allocations for the past 5 years. Assess the impact of the adjustments and allocations on the allowability of costs charged to LSC for that period.**

Response:

CALSC will insure that it has sufficiently detailed policies and procedures to address the proper handling of all transactions, including those identified by the OIG. Internal controls will be implemented (at the recommendation of CALSC's IPA, accountant, and Board of Directors) and submitted to the OIG for approval. Steps will be taken to fully document the cost allocation system in CALSC's Financial Manual.

CALSC will maintain documents supporting audit adjustments recommended by its IPA and will designate an employee to be responsible for review and implementation of any proposed audit adjustments. CALSC will work with its IPA to reduce the number of annual audit adjustments and to improve its accounting function. Adequate documentation will be maintained of all allocations and re-allocations. CALSC will seek input from its IPA, account, Board of Directors, and LSC.

Recommendations 12, 13, and 14:

12. **Ensure that LSC funds are not charged rent for use of the Gonzales space.**

13. **Should CALSC wish to use LSC funds in the future to help make mortgage payments on the Gonzales building loan, obtain formal approval from LSC and record LSC's interest in the property records for the building.**

14. **To the extent that rental costs are not recovered through the questioned cost process, formally establish LSC's interest in the Gonzales building for the remaining balance.**

Response:

CALSC denies that anything improper has occurred in connection with rental charges for the Gonzales office space. CALSC disagrees with the OIG's findings related to this building. CALSC will seek further guidance from its IPA and LSC regarding this situation. This building was not purchased with LSC funds nor has LSC funds been used for its maintenance and operation. LSC was fully advised of CALSC's purchase of this building and was well aware that CALSC charges LSC a fair market value for this office space. The location is near the courthouse, clerk of court annex, sheriff office, social service office and serves as CALSC disaster operation center for storms and other emergencies. This office was purchased in 2001 and has been reviewed by LSC and OIG personnel in the past.

CALSC will seek LSC's formal approval to continue to charge rent to LSC for the use of this building and to establish that LSC has no interest in this property.

Recommendation 15 and 16:

15. **Identify CALSC expenditures for vehicles and meals that were not adequately documented as business expenses and to the extent not reimbursed by the employee for whom they were made, record the expenses as fringe benefits:**

16. **For expenses determined to be fringe benefits as described in Recommendation 15, file amended W-2 statements for CALSC employees impacted and amended corporate tax returns in accordance with IRS regulations.**

Response:

CALSC has provided its records related to all expenditures for vehicle as well as of reimbursement for any personal expenses. It should be noted that CALSC has changed its method and procedure as to meals previously charged at various restaurants. When the corporation credit card is not available, the Executive Director (or any other CALSC employee) will pay the cost for business related charges and upon adequate documentation will be reimbursed for reasonable business expenditures.

If LSC funds are used to pay for goods or service and are subsequently reimbursed, the reimbursement will be recorded as LSC revenue as required by applicable guidelines and by the accounting manual for LSC recipients.

CALSC has taken steps to insure that both business related expenses and expenditures for employer provided vehicles are properly recorded, maintained, and reported to the IRS when applicable.

Recommendations 17 and 18:

17. **Establish adequate review processes to ensure that posting errors are identified and corrected.**

18. **Establish adequate review processes to ensure that transactions are accorded consistent treatment over time.**

Response:

CALSC's Financial Manual is being revised to provide procedures to ensure that posting errors are identified and corrected and that similar transactions are treated consistently.

Recommendations 19, 20, and 21:

19. **Establish procedures to ensure that interest on client trust funds is properly recorded and transferred to IOLTA in a timely manner.**

20. **Ensure that the appropriate reports are filed and payments made to the Louisiana Department of the Treasury with respect to Client Trust Funds that have been unclaimed for a period of over 5 years.**

21. **Establish procedures to (a) regularly review Client Trust Fund accounts to identify property that has been held for more than 5 years and (b) pay such property over to the Louisiana Department of the Treasury pursuant to the Uniform Unclaimed Property Act.**

Response:

Steps have been taken to ensure that interest earned on client trust funds is properly recorded as a liability and that the funds are submitted to the Louisiana Bar Association in accordance with the Interest on Lawyers' Trust Account (IOLTA) provisions. CALSC will work with the Louisiana State Bar Association and the Louisiana Department of the Treasury to determine the proper disposition of these funds. Efforts will be made to locate the client-owners.

CALSC has corrected the error that occurred when it changed banks and the new bank did not automatically send the interest to IOLTA.

<u>Conclusion:</u>

In summary, CALSC denies that it has improperly used LSC funds. It remains committed to improving its financial practices to insure that they meet all pertinent requirements including those described by the OIG, LSC, and CALSC's IPA. CALSC remains committed to working with LSC to ensure that its program complies with all applicable requirements.

CAPITAL AREA LEGAL SERVICES CORPORATION
VEHICLE USE POLICY

Capital Area Legal Services Corporation (CALSC) Board of Directors sets policy and guidelines for vehicles used by CALSC employees.

1. **CALSC'S Vehicle Use Policy**

   The Board of Directors authorizes the Executive Director the business use of the company vehicle 24hrs because of the nature of the Executive Director's work and for security purposes. Any personal incidental use, i.e., commuting to and from work, stopping at drug store, grocery store in route home or to the office, a trip log is not necessary. Personal intra-city and intra-state, a trip log (see attached) must be maintained and submitted to the Accounting Department monthly. Any extended use of corporate vehicle for personal use out-of-state must be submitted to the Board Chair or his designee for approval and a trip log must be maintained. The Executive Director and any employee will reimburse the corporation at a prevailing state rate per mile at the end of each month for personal use of the vehicle.

2. The Board of Directors authorizes the Executive Director to supervise the use of corporate vehicles for all corporate employees. The personal use of a corporate vehicle must be approved by the Executive Director.

   The Accounting Department will be responsible for filing any necessary reports to the Internal Revenue Services for the personal use of corporate vehicles at the end of each year on the employee's W-2 Form.

   The Executive Director authorized the Community Legal Education employee 24 hour use of the vehicle for security reasons. This employee is subject to the same use of the company vehicle as the Executive Director, i.e., for personal use must seek authorization from the Executive Director and must maintain a vehicle trip log.