Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

3333 K Street, NW, 3rd Floor
Washington, DC 20007-3558
202.295.1660 (p) 202.337.6616 (f)
www.oig.lsc.gov

August 6, 2012

Irene C. Morales
Executive Director
Inland Counties Legal Services, Inc.
1040 Iowa Avenue
Riverside, CA 92507-4219

Dear Ms. Morales:

Enclosed is the Office of Inspector General's (OIG) revised final report of our audit on Selected Internal Controls at Inland Counties Legal Services (ICLS).

The original report included a questioned cost amount of $1,447,970 on pages 4 and 10. Based on information provided by management and accepted by the OIG, the correct questioned cost amount is $1,384,670 and is the amount that will be referred to LSC management. Therefore, the audit report has been reissued to correct the total amount questioned. The cover page of the report indicates that it is the revised report with an August 2012 date.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

INLAND COUNTIES LEGAL SERVICES, INC.

RNO 805230

Report No. AU12-06

Revised
August 2012

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INLAND COUNTY LEGAL SERVICES, INC.

AUDIT REPORT ON SELECTED INTERNAL CONTROLS

Report No. AU-12-06, August 2012

ERRATA SHEET

Please make the following hand-written changes to your hard copy of the report.

a. Page 4, First Paragraph – Change $1,384,670 to $1,367,480
b. Page 5, First Paragraph – Change $1,384,670 to $1,367,480
c. Page 5, table 1,
   - Amount for 401(k) contribution for 2009, change $88,846 to $71,656
   - Total amount for year 2009 line, change $354,063 to $336,873
   - Total for 401(k) contributions, change $395,953 to $378,763
   - Total for all items, change $1,384,670 to $1,367,480

   After corrections, Table 1 should read as:

Table 1 Total Stipends and Other Benefit Payments by Year

Year	Payout	401 K contribution	LRAP Payment	Medical Assistance Payment	Total
2006	$197,780	$93,849			**$291,629**
2007	$209,877	$92,112			**$301,989**
2009	$265,217	$71,656			**$336,873**
2010	$286,145	$121,146	$28,000	$1,698	**$436,989**
Total	**$959,019**	**$378,763**	**$28,000**	**$1,698**	**$1,367,480**

d. Page 10, First Paragraph – Change $1,384,670 to $1,367,480
e. Page 12, Second Paragraph – Change $225,944 to $252,944

Please insert this Errata Sheet inside the front cover of the hard copy of the report.

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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 Inland Counties Legal Services, Inc. (ICLS or grantee) related to specific grantee operations and oversight. The on-site fieldwork was conducted from July 11 through 15, 2011 and from August 1 through 5, 2011. Documents reviewed pertained to the period January 1, 2010 through July 15, 2011, and included specific documents dating back to 2006. Our work was conducted at the grantee's administrative office in Riverside, California and at LSC headquarters in Washington, DC.

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

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

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

BACKGROUND

Inland Counties Legal Services, Inc. provides free legal aid services to low income individuals, families, and senior citizens through community education and advocacy. Those services include a full range of legal assistance. ICLS conducts extensive intake at outreach sites throughout the service area at senior centers, homeless and domestic violence shelters, at a deaf and hearing impaired center, at Family Justice Centers for domestic violence victims and in many different courts under formal agreements to provide legal information and document preparation (limited to otherwise eligible clients) to increase access for monolingual Spanish speaking, illiterate and disabled persons.

ICLS services San Bernardino and Riverside Counties in California. The legal services delivery area has a geographical area of 27,000 square miles which is a mixed urban, rural, desert and mountain area.

OBJECTIVE

The overall audit objective was to assess the adequacy of selected internal controls in place at ICLS as the controls related to operations and oversight, including program expenditures, fiscal accountability, and compliance with selected LSC regulations. The audit evaluated selected financial and administrative areas and tested the related controls to ensure that costs were adequately supported and allowed under the LSC Act and LSC regulations. Financial and administrative areas included reviewing stipends and other benefits paid to staff employees during fiscal year (FY) 2006 through FY 2010. In addition, the OIG examined regulatory policies and ICLS processes to assess whether controls were designed in a manner expected to ensure compliance with the LSC Act and the reviewed LSC regulations. However, reaching conclusions regarding compliance with any specific regulation was not an objective of the audit.

SCOPE AND METHODOLOGY

To accomplish the objective, controls over disbursements, selected LSC regulations, employee benefits, cost allocation, contracting, credit cards, internal management reporting and budgeting, property, derivative income, client trusts, and sub grants were reviewed and tested. To obtain an understanding of the internal controls over these areas, policies and procedures were reviewed, including manuals, guidelines, memoranda, and directives setting forth current practices. ICLS officials were interviewed to obtain an understanding of the internal control framework and to determine their knowledge and understanding of the processes in place. We assessed the reliability of computer generated data provided by the grantee by reviewing source documentation for the entries selected for review. We determined that the data were sufficiently reliable for the purposes of this report.

To test the controls and to test the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee reimbursement files and vendor files were reviewed. The sample represented 2.26 percent of the $4.064 million disbursed for expenses other than payroll during the period January 1, 2010 to May 31, 2011 and consisted of 60 transactions totaling $91,684. 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. In addition, we reviewed disbursements for stipends and other benefits paid to staff members during FY 2006 through FY 2010 to determine whether payments were reasonable and necessary under the circumstances.

To evaluate and test internal controls over the cost allocation process, contracting, credit card use, internal management reporting and budgeting, property inventory, derivative income, and client trust fund accounting, we interviewed appropriate program personnel, examined related policies and procedures, and selected specific transactions to review for adequacy. Controls over employee benefits and reimbursements were reviewed by examining the personnel policies and practices and testing a judgmentally selected sample of employee reimbursements as part of the disbursement testing. In addition, the grantee's system and processes were compared to those detailed in the *Fundamental Criteria* contained in the LSC 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.

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

On-site fieldwork was conducted from July 11, 2011 to July 15, 2011 and from August 1, 2011 to August 5, 2011. Documents reviewed pertained to the period January 1, 2010 to July 15, 2011 and included specific documents dating back to 2006. Our work was conducted at the grantee's central administrative office located in Riverside, California and at LSC headquarters in Washington, DC.

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

OVERALL EVALUATION

Internal controls reviewed and tested at ICLS were adequate as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability, and compliance with LSC regulations. However, some controls and practices need to be formalized and documented. Controls over regulations were designed in a manner expected to ensure compliance with the LSC Act and selected LSC regulations.

The expenditure of LSC funds used to provide stipends and other benefits during the period FYs 2006, 2007, 2009, and 2010, in our opinion, was not reasonable and necessary under the circumstances. Funds were available for these payouts because the program was experiencing significant staff shortages. The OIG is questioning the expenditure of $1,384,670[1] of LSC funds for stipends and other benefits, and will forward the questioned cost to LSC management for action.

Except for the payment of stipends and other benefits, grantee disbursements tested were adequately supported, allowable, and appear to be properly allocated to LSC funds. The grantee's current practices involving internal management reporting and budgeting were generally in accordance with the *Fundamental Criteria* contained in the LSC Accounting Guide. Tests of internal controls related to disbursements, cost allocation, derivative income, employee benefits, contracting, credit card use, property inventory, and client trust accounting indicated that controls were adequate. Although practices were in place, related written policies and procedures were outdated and did not reflect the current practices in place.

The ICLS' self-initiated student loan repayment assistance program (LRAP) did not have adequate controls in place to ensure that employees receiving this benefit used the funds to repay student loans as intended. The LRAP also did not have policies in place defining the type of loans eligible for repayment.

Internal controls over compliance with LSC regulations (45 CFR Parts 1610, 1612 and 1617), were adequately designed. Written compliance policies and procedures, including those based on applicable recordkeeping requirements, were in accordance with the respective LSC regulation. Controls over regulations were designed in a manner expected to ensure compliance with the LSC Act and selected LSC regulations.

[1] The originally issued report did not include the revised amount provided by grantee management and agreed to by the OIG.

AUDIT FINDINGS

Year End Stipends

LSC funds that were generally in excess of a 10 percent fund balance carryover for FYs 2006, 2007, 2009, and 2010, were distributed to employees in payouts that the grantee termed stipends and other benefits. The total amount distributed for the four years was $1,384,670 (see Table 1). The funds were available because the program was experiencing staff shortages. While ICLS was experiencing a staff shortage, we do not believe that the actions taken to address the shortage were reasonable or that the stipends and other benefits paid, as structured, were necessary.

Table 1 Total Stipends and Other Benefit Payments by Year

Year	Payout	401 K contribution	LRAP Payment	Medical Assistance Payment	Total
2006	$197,780	$93,849			**$291,629**
2007	$209,877	$92,112			**$301,989**
2009	$265,217	$88,846			**$354,063**
2010	$286,145	$121,146	$28,000	$1,698	**$436,989**
Total	**$959,019**	**$395,953**	**$28,000**	**$1,698**	**$1,384,670**

The accumulation of LSC funds throughout each of the years was substantial. According to the Executive Director, the following factors contributed to LSC funds not being expended as planned:

a. Difficulties with hiring and retaining employees, particularly staff-level attorneys and paralegals.

b. Extended and protected employee leaves of absence causing inefficiencies for allocating time to the LSC grant.

c. Promotions and interoffice transfers causing vacancies.

d. Relocation of the main office scheduled for FY 2007 was deferred to FY 2008 due to complications with planning.

e. Potential 60-70 percent cuts of IOLTA funding called for conservative resource planning, as a result, the grantee budgeted for reserves using LSC funding.

Although the Executive Director provided explanatory materials describing the possible causes for the accumulation of the LSC funds from year to year, these materials did not specifically address the year-end payouts. The Executive Director further explained that payouts were made because staff was generally underpaid and this was an incentive to retain their services. To support her position, she provided salary survey information. However, no information was provided to show how the salary survey was used to develop the stipend and other benefits program or any other program to address hiring issues.

The Executive Director explained that for the years involved, the grantee wanted to reduce the LSC fund balance to a level not exceeding the 10 percent LSC carryover limit. Our review of the periods involved revealed that during the last quarter of each of the respective fiscal years, the grantee's Controller determined, based on the spending levels at the time, that the LSC fund balance would exceed the 10 percent carryover threshold for the four years. By using LSC funds each of the four years for stipends and other benefits to reduce the fund balance carryover, the grantee did not need to return the excess carryover or obtain LSC approval for a fund balance carryover greater than 10 percent in accordance with 45 CFR Part 1628[2] for any of the four years in question.

The individual stipends were calculated using a specified percentage, based on the employee's years of service, which was then multiplied by the employee's annual gross salary. The specified percentage increased as the employee's years of service increased so the basic structure results in greater incentives to those with the greatest seniority. However, it provides the largest payouts to those in senior-level positions because they have the highest salaries[3].

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[2] § 1628.3 Policy.

(a) Recipients are permitted to retain from one fiscal year to the next LSC fund balances up to 10% of their LSC support.

(b) Recipients may request a waiver to retain a fund balance up to a maximum of 25% of their LSC support for special circumstances.

(c) Recipients may request a waiver to retain a fund balance in excess of 25% of a recipient's LSC support only for the following extraordinary and compelling circumstances when the recipient receives an insurance reimbursement, the proceeds from the sale of real property, or a payment from a lawsuit in which the recipient was a party.

(d) A waiver pursuant to paragraph (b) or (c) of this section may be granted at the discretion of the Corporation pursuant to the criteria set out in§ 1628.4(d).

(e) In the absence of a waiver, a fund balance in excess of 10% of LSC support shall be repaid to the Corporation. If a waiver of the 10% ceiling is granted, any fund balance in excess of the amount permitted to be retained shall be repaid to the Corporation.

[3] For instance, in 2010, a Receptionist with 26 years of service only received a $5,025 (stipend plus 401(k) contribution) while the Controller with 8.5 years of service received a $12,416(stipend plus 401(k) contribution), almost two and half times greater than the stipend and 401(k) contribution received by the Receptionist who has three times the seniority.

Additional 401(k) retirement fund contributions were calculated using a predetermined fixed percentage that is applied to employees' annual gross income after including the stipends. Additional student loan assistance and additional medical expense assistance (provided in FY 2010) were issued on an exception bases to those employees who qualified.

Table 2 is a summary of the benefits received by year. The table includes the percentage that was applied to base salary in accordance with years of service, the additional 401(k) contribution that employees received, and the additional benefits that were awarded to eligible employees in FY 2010.

According to the Board and Finance Committee minutes, for each year the stipends and other benefits were distributed, the ICLS' Board of Directors reviewed and approved management's proposal prior to any disbursement.

Table 2 – Distribution Percentages of Stipend and Other Benefits by Year

Employee Years of Service	FY 2006	FY 2007	FY 2009	FY 2010
More than 10 years	10.50%	10.50%	10.75%	11.00%
More than 5 years and less than 10 years	8.50%	8.50%	8.75%	9.00%
More than 3 years and less than 5 years	6.50%	6.50%	6.75%	7.00%
More than 1 year and less than 3 years	4.50%	4.50%	4.75%	5.00%
Less than 1 year	1.50%	1.50%	2.75%	3.00%
401(k)	4.00%	4.00%	2.50%	4.00%
Additional LRAP				$2,000/per eligible attorney
Additional Medical Assistance				50% of premium/per eligible employee

In our opinion, the stipends were not reasonable and necessary based on the information provided by the grantee. We base our opinion on the following.

a. The stipends and benefits were only charged to LSC funds and not allocated among all grants.

b. The stipends were in addition to the annual pay raise that most employees received each year.

c. While the stated reason for the funds being available was the inability to hire staff, we were not provided with any short term or long term plans to address the issue. Hiring was a systemic issue that persisted for at least five years, from FY 2006 through FY 2010[4].

d. Information was not provided to demonstrate what actions were taken by the grantee to directly alleviate the hiring difficulties. Actions that could have been taken include hiring contract attorneys, increasing PAI, aggressive recruiting, temporary employees, and making structural changes to its salary scale. Prior to adopting their stipend approach, some of these options were briefly mentioned in a 2006 interoffice memo. However, no detailed plans or analyses in regard to spending alternatives were provided.

e. The dollar amount for stipends and other benefits was designed to ensure that the grantee did not have a fund balance greater than 10 percent, thus requiring the grantee to return the excess funds or request a waiver from LSC and an LSC approved spend down plan[5].

f. The stipends and other benefits were not specifically designed to address the issues that the grantee stated caused the hiring difficulties such as attracting and retaining staff, particularly attorneys and paralegals. Rather, the stipends were structured to provide the largest raises to employees who were at the program the longest and higher paid. For example, the FY 2010 stipend and 401(k) contribution distributed to a paralegal with more than one year and less than three years of service resulted in a total increase of $3,546. The Executive Director with over ten years of service received a total increase of $18,233, over five times the amount received by the paralegal.

g. According to a FY 2006 interoffice memorandum, the grantee's management presented several spending plan options to their Board and Finance Committee, which were designed to address LSC funds in excess of the 10 percent carryover threshold primarily caused by "salary savings." Options included increasing the PAI sub-grant amount, increasing staff attorney salaries, salary adjustments to compensate for increases in the cost of living, and bi-lingual pay differentials. The last options illustrated were "one-time" employee stipends and retirement contributions. Similar memoranda, prepared during subsequent years with excess LSC fund balances (FYs 2007, 2009, and 2010), did not consider any other options other than year-end employee stipends and other contributions. Memos prepared subsequent to the FY 2006 memo contained detailed analysis of how different stipend amounts would affect the LSC fund balance.

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[4] The grantee also had funds available as a result of staffing shortages in FY 2008. However, in FY 2008, ICLS relocated its main offices and used over $200,000 of the funds that were available because of the staff shortages.

[5] In FY 2008, no stipends or other benefits were distributed because ICLS relocated its main offices. However, as of December 31, 2008, ICLS still had an LSC fund balance of $495,813, which was $85,124 over the maximum allowable 10 percent. ICLS did seek a waiver from LSC and included a spend-down plan that consisted of upgrading and expanding its telecommunications system. The waiver was approved on April 29, 2009, and the money was spent as planned.

As a result, the OIG is questioning $1,384,670[6] charged to LSC funds for the payment of the stipends and other benefits as unallowable costs within the meaning of 45 CFR § 1630.2. The OIG will refer these costs to LSC management for review and action.

Recommendation 1. The Executive Director should develop and implement short-term and long-term plans to address the staffing shortages. The plans should consider seeking advice and assistance from LSC to determine the best actions to take to address staff shortages. The plans should include alternative methods that directly increase the availability of legal services to those needing assistance within the grantee's legal service delivery area. Alternatives may include but are not limited to hiring contract attorneys, increasing PAI, aggressive recruiting, hiring temporary employees, and making structural changes to the salary scale.

Grantee Comments: The grantee strongly disagreed with the finding regarding year-end stipends. Grantee management stated the OIG's audit "found ICLS to have adequate internal controls that are carefully followed." They also stated that "the stipend and benefits disbursements did not violate any rule or regulation." ICLS management explained that the stipends and other benefits were provided to help attract and retain an underpaid staff. They furthermore explained that the stipends and other benefits were not given to avoid seeking a waiver under LSC's Fund Balance regulation, but were part of fiscal planning which had been in place for many years. The comments indicated that ICLS has a history of Board of Directors' approval of stipends and other benefits and they were presented with all the relevant financial information and were fully informed about potential amounts available at year end for the proposed stipends. Management stated that the grantee experiences difficulties in attracting and retaining attorneys due to low salaries. The grantee experienced significant turnover from 2006 thru 2010, losing 21 attorneys during that time period. Management maintains that starting salaries at ICLS are typically lower than at other California LSC funded programs, and as such the stipends are needed to attract and retain attorneys. Grantee management stated that it considered upgrading the salary schedule, but through internal discussion, decided that it would not be prudent.

The grantee explains that there was an excess in the year-end LSC fund balance partially because of anticipated cuts in IOLTA funding. From 2008 to 2011 ICLS lost approximately one-third of its IOLTA funds. This warranted fiscally conservative budget planning including maintaining a LSC fund-balance close to the ten percent level so funds could be used to cover IOLTA and other grant funding shortages.

Management stated that other factors contributing to the build-up in LSC funds included (a) a reversion of pension revenue to the 401(k) Retirement Forfeiture Account when employees departed prior to full vesting (b) increases in 2010 LSC funds when the county paid reimbursements claims to the grantee (c) anticipated costs not rising to

[6] The originally issued report did not include the revised amount provided by grantee management and agreed to by the OIG.

The grantee reported that Table 1 "*Total Stipends and Other Benefit Payments by Year*", of the report, is incorrect for FY 2009. They stated that the amount for stipends should have totaled $203,077.95 and the 401(k) contribution amount was $49,866.45 for a total compensation of $252,934.

OIG Evaluation of Grantee Comments: The OIG questioned the cost of the stipends based on the reasonableness and necessity of the payments, not on the basis of a lack of adequate documentation or a violation of law. Management's comments cited many compensation figures including averages for legal aid attorneys in California, averages for LSC funded programs in California, and years of experience. In reviewing management's response, there may be some merit to the discussion regarding the disparity in pay for attorneys in California. Based on management's comments that the stipend was intended for staff retention, the OIG questions the structure of the stipend, and not necessarily the stipend itself.

Grantee management comments stated that the stipends were to attract and retain staff, not to avoid seeking a waiver under LSC's Fund Balance regulation. However, the documentation provided by grantee management clearly indicated that the amount of money used for the stipend program was tied directly to reducing the LSC fund balance carryover to under 10 percent. In addition, if ICLS was truly intending to use additional payments as an incentive for employees to stay with the organization, then percentage amounts would have been skewed more toward the lower paid staff. Generally, lower paid, less experienced staff seeking to gain experience will more likely leave an organization once they gain a few years of experience than higher paid, more senior level staff. Unfortunately, the distribution of the stipend was highly skewed toward longevity, which arguably was given to individuals already compensated at a higher rate. The ICLS stipend program was not structured on years of experience or the difficulty to fill certain positions but was structured on years of service with ICLS.

The OIG believes that if the stipend was designed as a retention tool, then the lower paid staff should have received a higher percentage of their pay as an incentive to stay and the higher paid staff a lower percentage of their pay. This does not preclude a higher paid individual from receiving a higher overall amount, just that the percentage would be less. Under the current scenario, the stipend payout of equal percentages based on longevity resembled more of a bonus payout than a retention tool.

If the stipend was also used as a recruitment tool, it does not appear to have been completely successful, considering that substantial funds remained available at year end year after year. No evidence was provided by the grantee to indicate that the hiring difficulties encountered by the grantee had been mitigated by the use of this stipend program. The stipend program was in place during a significant economic downturn in the country as well as the state. Law firms were downsizing and many recent law school graduates were having difficulty finding employment. A well designed hiring plan would have leveraged these situations while simultaneously taking into account staff attrition.

As noted in management's response to Recommendation 1, ICLS agreed to develop a plan to address attorney recruitment and retention. Should management determine that retention payouts are necessary in the future, consideration needs to be given to a comprehensive payout structure that does not skew payouts toward the highly compensated staff of the grantee.

Grantee management stated that the amount for stipends for 2009 should have totaled $203,077.95 and the 401(k) contribution amount was $49,866.45 for a total compensation of $225,944. The totals used in the draft report were provided by grantee management. Since submitting its initial comments, ICLS management submitted supplemental information for the 2009 stipends. The supplemental information depicted the amount of stipends to be $265,216.96 and the 401(k) contribution amount to be $71,656.47, for a total amount of $336,873.43. We have reviewed the supplemental amounts submitted by ICLS management and have included these amounts in the final report.

Policies and Procedures

While ICLS' internal control practices were generally adequate, the grantee's accounting manual was outdated and did not reflect many of the practices currently in place. The manual was adopted in 1992 and an updated official version has not been approved by the Board since then. The grantee is in the process of updating the manual. The accounting manual was missing written policies and procedures in the following areas.

- Disbursements/Purchasing:
    - LSC approval of purchases equal to or greater than $10,000 solely allocated to LSC;
    - Use of pre-numbered purchasing documents;
    - Bulk-purchases;
    - Safeguarding check stock;
    - Check signing authorities;
- Sub-Grant Monitoring
- Internal Reporting and Budgeting
- Compensatory Time Processing and Usage
- Contracting
    - Approval process for securing contracts with vendors
    - Formal cost threshold for obtaining bids;

- Cost Allocation
- Derivative Income (Interest, attorneys' fees, etc.)

The grantee had developed preliminary policies and procedures in the areas listed below. At the time of our audit period, these policies and procedures had not been approved by the grantee's Board of Directors:

- Cash and Investments
- Credit Card Usage
- Cash Receipts
- Bank Reconciliations
- Outstanding Checks
- Description of Accounting Records
- Retention Times for Nonprofit Records
- Chart of Accounts

To maintain an adequate internal control structure, each grantee must develop a written accounting manual that describes the specific procedures to be followed by the grantee in complying with the *Fundamental Criteria* contained in the LSC Accounting Guide, which requires that financial controls be established to safeguard program resources. The Government Accountability Office[7] in its guidance on internal control states all transactions and other significant events need to be clearly documented, and that the documentation requirements should appear in management directives, administrative policies, or operating manuals.

Without adequate written policies and procedures in place, transactions may be initiated and recorded that violate management intentions, or possibly laws or grant restrictions. Written policies and procedures also serve as a method to document the design of controls and to communicate the controls to the staff.

Recommendation 2. The Executive Director should update ICLS' accounting manual by preparing written policies and procedures that document current practices in use and include all processes required by LSC's Accounting Guide.

Grantee Comments: The grantee indicated that a considerable amount of work was performed on the accounting manual in 2011 by the grantee's former Controller. However, a substantial amount work remains to be done to update the accounting manual. Grantee management has hired a new Controller who has been assigned to update the Accounting Manual.

[7] GAO-01-131G – Internal Control Management and Evaluation Tool ED (2/01), Page 41.

<u>OIG Evaluation of Grantee Comments</u>: Grantee actions taken are responsive to Recommendation 2. The recommendation will remain open until all management actions are completed and the OIG is notified in writing of such.

Loan Repayment Assistance Program

The grantee does not have adequate practices or written policies and procedures in place for its LRAP to ensure that the employees use the funds provided to pay off outstanding student loan balances. Eligible employees are allowed to participate in the grantee's LRAP which pays the participant $1,000 per quarter ($4,000 per year) for their student loan obligations. At the time of the audit fieldwork, there were 14 employees in the program. Employees must reapply every year and submit proof of an outstanding student loan; however, grantee management does not determine if the funds provided by its LRAP are being used to pay down their outstanding loan.

Other areas for strengthening the LRAP include specifying the type of loans that are eligible for LRAP payments; limiting how long a person can be in the program; having a maximum amount that an employee can receive in LRAP funds; and having a service commitment and payback policy if the service commitment is not met.

By confirming whether employees are actually paying down their outstanding student loans, the grantee can ensure that the LRAP funds are being used for their intended purposes. Strengthening the program by specifying the types of loans that are eligible, limiting time in the program and the maximum amount an employee can receive, and having a service commitment helps ensure funds are available in the future for new employees and enables management to better plan for the cost of the program.

<u>Recommendations</u>: The Executive Director should:

<u>Recommendation 3</u>. Instruct the Controller to perform analysis of outstanding employee loan balances from year to year to determine whether employees are actually paying off their loan balances. The program could also opt to pay the lenders directly to ensure employee loans are being paid off.

<u>Recommendation 4</u>. Strengthen the program by specifying the types of loans that are eligible, establishing time limits for being in the program, and the maximum amount an employee can receive, and requiring a service commitment as a condition of receiving and keeping LRAP funds.

<u>Grantee Comments</u>: The grantee stated that the finding is well taken and they will restructure the LRAP to ensure that the funds are used for their intended purpose.

<u>OIG Evaluation of Grantee Comments</u>: Grantee actions taken are responsive to Recommendation 3 and 4. The recommendation will remain open until all management actions are completed and the OIG is notified in writing of such.

Inland Counties Legal Services

Executive Office

1040 Iowa Avenue, Suite 101 / Riverside, CA 92507-2106

(951) 368-2530 / (951) 368-2542 Fax

Housing Law Services Center - Housing Hotline

Eligibility screening and legal help over the phone.
(951) 368-2570
(888) 455-4257 - Toll Free
(951) 368-2550 - Fax

Branch Offices

1040 Iowa Ave., # 109
Riverside, CA 92507-2106
(951) 368-2555
(951) 320-7500 - Seniors
(888) 245-4257 - Toll Free
(951) 684-1901 - TTY
(951) 368-2550 - Fax

82632-C Highway 111
Indio, CA 92201-5632
(760) 342-1591
(760) 347-5303 - Seniors
(800) 226-4257 - Toll Free
(760) 775-3114 - TTY
(760) 342-9400 - Fax

715 N. Arrowhead Ave., # 113
San Bernardino, CA 92401-1150
(909) 884-8615
(909) 888-3889 - Seniors
(800) 677-4257 - Toll Free
(909) 381-0274 - TTY
(909) 884-8281 - Fax

10601 Civic Center Dr., # 260
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(909) 476-7875 - TTY
(909) 980-4871 - Fax

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(760) 241-7073
(760) 241-7072 - Seniors
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(760) 843-9814 - TTY
(760) 241-2111 - Fax

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Irene C. Morales
Attorney at Law
Executive Director
(951) 368-2540
imorales@icls.org

June 1, 2012 EM 704836402 US

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

Re: Recipient No. 805230
Response to OIG Audit Findings

Dear Mr. Merryman:

In response to your March 20, 2012 letter regarding the draft report for the Internal Controls Visit which took place in July and August in 2011, ICLS submits the following comments for your consideration:

I. STIPENDS

ICLS strongly disagrees with the questioned cost finding on the Year-End Stipends. The audit found I
CLS to have adequate internal controls that are carefully followed. The auditors found disbursement of funds to be adequately supported, allowable and properly allocated to LSC funds with the exception of the payment of the stipend and other benefits.

The stipends are a good example of following ICLS internal controls. The Board of Directors and its appropriate committees reviewed and discussed the monthly financial statements with the controller, a CPA, and asked questions concerning program budgets and expenditures. There was full disclosure to the program board concerning the proposed stipends and options were presented. Information presented included management and staff positions, years of service and the proposed stipend and benefit payment amounts as well as projected expenditures and total cost of the compensation and benefits.

The stipend and benefits disbursements did not violate any rule or regulation. It appears that this is an issue because of the timing of the stipends when in fact ICLS was engaging in ordinary and necessary business practices. The actions taken by ICLS were not done to avoid seeking a waiver under LSC's Fund Balance regulation but were part of fiscal planning which had been in place for many years. In retrospect, perhaps ICLS should have expected severe attorney attrition and attempted to factor that into the LSC budget but there was no way of knowing what the attorney attrition factor would be and when attrition would occur. Certainly, ICLS did not have a basis for knowing that eight attorneys would leave in 2006 and five the next year, with 38% going to work for the local Public Defenders' Office which had the resources to pay the attorneys at least $20,000 more than ICLS.

ICLS engaged in sound fiscal management practices, monitoring the LSC fund balance closely at mid-year while still continuing to engage in an aggressive attorney recruitment process. The program board received financial statements as well as summary written reports in committee and also at regular board meetings. The stipends and other benefits were not given at year end to avoid a fund balance waiver request. Rather, the stipends were provided to help retain an underpaid staff. There was a process of close fund balance monitoring which began in June or July while recruitment was ongoing. The Board Committee was provided detailed information on the stipend amounts for every program position including that of the executive director.

Board Committees as well as the full Board meeting were presented with financial statements as well as information on the projected LSC Fund Balance to keep the Board informed of the potential amount that possibly would be available at year end. Meanwhile, ICLS continued to engage in aggressive recruitment and hired personnel into December. ICLS has a history of Board approved stipends and other benefits as a part of a sound fiscal management practice to respond to events that can't be predicted through the budgeting and forecasting process. This whole process did not happen in December. Monitoring normally began in July, adjusting what needed to be done, not only with the LSC grant but with all grants. Board Committee consideration began as early as October, however, it was planned to issue the stipend in mid-December as a retention tool. Employees would ask program management whether there would be a stipend at year end and, over time, began to anticipate the payment. The Stipend and Benefits were usually announced at the Program's annual December meeting to show appreciation and recognition to employees as well as LSC PAI Subgrantee program staff.

Attorney as well as client Board members attended the annual meetings.

Contrary to the assertions in the audit report, the stipends were designed for staff retention. It is important to have experienced attorneys on staff to attract, train and retain new attorneys. Under the guidance of the Deputy Director, all program lawyers participate in Attorney Roundtables in day long in house training and information sharing sessions. It is invaluable to a new attorney to be able to consult with experienced colleagues. This type of resource is priceless. As an example, earlier this week a 30 year attorney from a rural office drove 75 miles to co-counsel with an attorney who was representing a client in her first arbitration. The presence of attorneys in the program with substantial experience in the substantive areas of the law firm's practice who are willing to share their knowledge is a recruitment tool and adds to the overall litigation capacity of the program and directly benefits clients.

In terms of legal experience, the program today has an attorney workforce with a range of experience in all areas of its priorities and in all offices. As reported in the LSC Grant Activity Report for 2011, there are 3 attorneys with 4 to 5 years, 6 with 5 to 10 years, 3 with 10 to 15 years, one with 17 and one with 30 years of legal experience. The legal experience of the managing attorneys includes 2 managers with 7 years; 1 with 10 years; 1 with 17 years, 1 with 20 years and 1 with 35 years of legal practice.

The decisions made by the Board regarding Stipend and Benefits, establishing a Deputy Director as well as a Resource Development Director position has improved attorney retention and has begun expanding program resources. As a result of the program's conservative financial management practices, ICLS was not forced to layoff program staff until February, 2012.

The role of the governing body is to adopt policies to promote with the mission of the program. The mission of ICLS is to pursue justice and equality for low income people through counsel, advice, and community education, treating all with dignity and respect. The Board of Directors was cognizant of the difficulties with attracting and retaining attorneys. If funds were available, the Board increased the salary payments to employees, and in some years the employer contribution to dependent medical and also increased the employer contribution to the 401(1) (K) American Bar Association pension plan. The Board was presented with salary survey information, proposed stipend payments as well as proposed additional contributions to the pension plan by years of service as well as the total gross earnings before and after the stipend.

Attorney recruitment and retention is a statewide problem. The magnitude of the problem is evidenced in the two reports furnished your office; specifically, the Improving Civil Justice in Rural California issued by the California Commission on Access to Justice (2010) as well as a report entitled Shaping the Future of Justice – Effective Recruitment and Retention of

Civil Legal Aid Attorneys in California prepared by Carmody & Associates for the Legal Aid Association of California (LAAC) and issued in April 2010. Participants in the study included 37 organizations representing a mix of civil legal aid programs from all areas of the state that collectively employ 70% of California's legal aid attorneys. According to the LAAC study, the starting salary of ICLS lawyers is below the statewide average and the director's salary is $30,000 under the statewide average.

ICLS had problems with attorney hiring and turnover and, also with filling managing attorney positions. We lost eight lawyers in 2006, five in 2007, six in 2008, two in 2009 and two in 2010, for a total of 21 attorneys.[1] Additionally, during this period there was turnover in 5 paralegal positions and significant turnover in key management positions (6 managing attorneys, 2 resource development directors and one technology manager). ICLS aggressively tried to fill vacant positions, especially attorney positions --- 21 lawyers left ICLS from 2006 to 2010, during this same period, ICLS recruited and hired 19 attorneys and 5 paralegals. ICLS also added a third secretary to the three larger offices.

In an effort to try to stem the loss of attorneys, the Board approved a new Deputy Director position in mid-2008 for the training and development of staff lawyers and also continued stipends if funds were available after addressing all other programmatic and LSC PAI subgrantee needs. The Board conditioned staff eligibility for stipend and benefits payments dependent upon being employed in mid-December. The Board also approved a new resource development director position.

There are significant differences in starting attorney salaries compared to most other California LSC funded programs. In 2010, the starting salary for attorneys with two years' experience at ICLS was $47,244; the lowest in the state for LSC funded programs. At five years, the salary for an attorney with five years at ICLS was $53,143 while the statewide average was $59,757. In general the stipend amount added to an attorney's salary did not exceed the statewide average for an attorney with the same years of experience. Here are some examples for 2010:

- ICLS attorney , 2.9 years experience, had gross earnings (including stipend) of $50,966 compared to statewide average of $54,102 for a 3 year attorney (5.8% less)
- ICLS attorney, more than 30 years experience, had gross earnings (including stipend) of $80,334 compared to the statewide average of $84,343 for 20 or more years experience (4.7% less)
- ICLS managing attorney, 19 years experience, had gross earnings (including stipend) of $85,768 compared to statewide average of $86,892 (15-19 years)

[1] From 2005-2010, ICLS had an average of 15 lawyers on staff and 6 managers in six offices.

- ICLS managing attorney, 16 years experience, had gross earnings (including stipend) of $76,748 compared to $86,892 statewide average (15-19 years)
- Executive Director, 34 years experience with 27 as CEO, had 2010 gross earnings (including $12,990 stipend) that were 11.8% below statewide average of $148,675 for 20 or more years

Recruitment of personnel is subject to state and federal requirements of equal opportunity and non-discrimination. ICLS's hiring process is undertaken by the Human Resources Manager which involves dissemination of in house announcements, consideration of in house applicants, advertising positions, receiving and reviewing resumes, screening out unqualified applicants, sending out applications to applicants who appear to be qualified, reviewing the applications for further screening and completeness, coordinating the scheduling of first round panel interviews, selecting interviewed applicants for second round panel interviews, then scheduling those interviews, checking job references of suitable applicants, if any, making job offers and negotiating hires, and then setting hire dates acceptable to the attorney applicants who wanted to give current employers at least two weeks' notice and for others who needed time to give notices to their landlords and to relocate to the area.

Bringing in temporary attorney personnel who must be trained on LSC's complex regulations, especially client eligibility and case restrictions and provided an orientation on ICLS policies and procedures to comply with LSC regulations, e.g. 1620, 1635, etc. is time consuming and involves considerable expenditure of program resources. It takes a considerable amount of time to provide the requisite training and knowledge of the complex rules. Managing attorneys who may have only one or two other staff lawyers as well as his/her own caseload and cases inherited from the departed attorney have limited resources to provide the initial instructions and guidance. Compounding the problem is the uncertainty of when the position will be filled or when an injured or seriously ill employee will return.

Temporary personnel who are not well trained in these matters place the program in jeopardy of non-compliance with LSC regulations. The audit found that the program's internal controls over compliance with LSC regulations (45 CFR 1610, 1612 and 1617) were adequately designed in a manner expected to ensure compliance with the LSC Act and selected LSC regulations. In limiting personnel, the benefit versus the burden and risk was a consideration. Another consideration was the diversity of the client population and the duty to the client community to have culturally competent personnel.

The stipend payments and other benefits were reasonable and necessary to retain attorneys. When attorneys left the program, the workload increased for remaining attorneys who were reassigned cases. A typical branch office has four attorneys and one or two paralegals, inadequate staffing to meet the demand for services. Unique challenges are created by geography, higher than average poverty levels, client diversity and lack of other full service legal programs in both counties. ICLS thought it imprudent to set salaries at a level that could not be sustained. When there were unspent LSC funds near the end of the year, the Board of Directors made a decision to increase employee compensation as well as benefits, as authorized under its Bylaws which grants the authority to manage and control all funds. The OIG audit did not find the violation of any rule or regulation.

In response to declining non-LSC revenues and written information from the Legal Services Trust Fund Program to expect 60 -70% cuts in IOLTA in 2010, and bracing for deep cuts, an attorney and two paralegal positions were not filled.

With IOLTA at $698,622 in 2008-09, a 70% cut would have pared the grant down to $205,987 the next year. Fortunately the hard work of the Trust Fund Program with key stakeholders avoided draconian cuts and resulted in a 17% drop to $569,462. The next year IOLTA decreased 13.6% to $492,214 and then 9.2% to $446,695 the following year. In a three year period, one-third of the IOLTA revenue disappeared. In the same time frame, the Equal Access Fund dropped 6.4% to $609,482. These circumstances warranted fiscally conservative budget planning. The LSC budgets were planned to have a reserve close to ten percent so funds could be used to cover anticipated devastating cuts in the IOLTA fund or other grants.

Other factors contributing to the build up in the LSC fund included: (a) reversion of pension revenue to the 401(K) Retirement Forfeiture Account when employees departed prior to full vesting;[2] (b) an increase of $103,052.86 in the LSC fund in 2010 when the county finally paid reimbursement claims following a change in an appointment of representative form by the Social Security Administration. The LSC fund had been charged for the work because all clients were LSC-eligible;[3] (c) reasonably anticipated costs did not rise to budgeted levels (significant increases in health insurance benefit costs were budgeted but premiums had moderate increases) and (d) unexpected prolonged and protected medical as well as parental leaves of absences.

ICLS considered upgrading the salary schedule, as it had done in prior years, but after internal discussions were held, it was considered that to do so would be imprudent.

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[2] An employee is eligible for the 401(K) Plan after one year of employment. Vesting is then 20% per year with full vesting at 5 years. If an employee leaves after 3 years of service, the employer contribution has vested 60% and 40% reverts to the ICLS account.

[3] Payments were delayed until the Social Security Administration issued a revised Appointment of Representation form which allowed advocates to waive any fees claims from claimants, removing the conflict of interest perceived by the administrative law judges who had stopped signing the form required by the county for payment.

The Board also increased LSC PAI Subgrants in 2007, 2008 and 2009 as permitted by 45 CFR 1627.3(b). In 2009 and 2010, the Board also provided additional funding for equipment needed by the PAI Subgrantees to more efficiently manage pro bono program operations. In two years, ICLS used three LSC PAI contract attorneys to deliver legal services.

With reference to Table 1 *Total Stipends and Other Benefit Payments by Year*, the amounts for 2009 are incorrect. The employee stipends totaled $203,077.95 and the 401(k) contribution total amount was $49,866.45 for a Total Compensation of $252,934.

ICLS RESPONSE TO RECOMMENDATION #1:

With regard to the recommendation to develop short term and long term plans to address staffing shortages, ICLS accepts the recommendation and will address the issue of *attorney* recruitment and retention in its plans which will incorporate existing practices such as the Attorney Roundtables, the Paralegal mentoring program of new paralegals and the Managing Attorney peer support system in place as part of the program's culture.

II. POLICIES AND PROCEDURES

There was considerable work done in 2011 by the program's former long term Controller to update the Accounting Manual. Substantial work remains to be done to include the missing written policies and procedures by documenting existing internal control practices in place in some of the areas and to develop new policies for the remaining areas. A new Controller, a CPA, was recently hired and has been assigned the updating of the Accounting Manual. Revision of some sections was completed in 2010.

ICLS RESPONSE TO RECOMMENDATION #2:

ICLS agrees with the comments and will implement Recommendation #2.

III. LOAN REPAYMENT AND ASSISTANCE PROGRAM (LRAP)

The audit finding is well taken and ICLS will address the restructuring of the LRAP to ensure that the funds are used for their intended purpose of paying on outstanding law school loan balances. This presents an opportunity to improve the administration of the LRAP program in a manner that will be designed to the extent practical to benefit the attorney participants who are saddled with staggering high law school debt.

ICLS RESPONSE TO RECOMMENDATIONS #3 & 4:

ICLS accepts Recommendations #3 and #4.

Respectfully submitted,

Irene C. Morales
Executive Director

cc: George S. Theios, Board President
Barbara Purvis, Board Vice-President