Office of Inspector General
Legal Services Corporation

Inspector General
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September 30, 2016

Mr. Thomas Holgate
Executive Director
DNA-Peoples Legal Services, Inc.
Route 12, Highway 264
Window Rock, AZ 86515

Dear Mr. Holgate:

Enclosed is the Legal Services Corporation (LSC) Office of Inspector General's (OIG) final report on our audit on Selected Internal Controls at DNA-Peoples Legal Services, Inc. Your comments are included in the final report as Appendix II.

The OIG considers the proposed actions to address Recommendations 1 through 19 as responsive. The actions planned by grantee management to address the issues and revise and update its Accounting Manual should correct the issues identified in the report. However, 16 of the recommendations will remain open until the OIG has been notified in writing that the proposed actions have been completed and the necessary supporting documentation provided.

Recommendations 4, 17 and 18 are considered closed.

The OIG is referring $32,614 in questioned costs to LSC Management for their determination. These costs include $30,177 in indirect salaries and $2,437 in other indirect costs that the OIG believes were over allocated to LSC.

Please provide us with your response and additional documentation to close out the remaining 16 recommendations along with the revised Accounting Manual within six months of the date of this final report.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings, Vice President
For Grants Management

DNA-People's Legal Services, Inc.
Chee Smith, Jr.
Board Chairperson

Sent by E-mail to Board of Directors
Charles W. Doughty
Peter Ives
Robert C. Begay
Judy Dworkin
Lewis King
Karl Gillson
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Mack W. Olsen
Richard T. Tsosie
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LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

DNA-PEOPLE'S LEGAL SERVICES, INC.

RNO 703068

Report No. AU 16-10

September 2016

www.oig.lsc.gov

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INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at DNA-People's Legal Services, Inc. (DPLS or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Window Rock, Arizona 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

Since 1967, DNA-Peoples Legal Services has provided free civil legal assistance and representation to low-income people, who otherwise could not afford to hire an attorney. It provides representation in the U.S. and tribal courts, promotes tribal sovereignty, and offers community education programs that promote greater understanding of the law. DPLS services have helped people use existing policies and laws to protect their property and assets, to stay safe from physical, mental, and financial abuse, to avoid exploitation, and to safeguard their civil rights. DPLS has 10 offices which serve Coconino, Northern Apache and Northern Navajo counties in Northeastern Arizona, San Juan and Rio counties in Northern New Mexico, and San Juan County in Southeastern Utah. DPLS service areas include tribal areas of Navajo, Hopi, Havasupai, Hualapai, San Juan, Southern Paiute, Kaibab Paiute, and Jacarilla Apache.

According to the audited financial statements for the grantee's year ended December 31, 2014, approximately 73 percent of the grantee's total revenue and support was provided by LSC grants. DPLS received $3,244,858 from LSC, $322,978 from non-LSC, $457,460 from Other Federal grants, and $398,482 from Foundation grants and other contributions.

OBJECTIVE

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

AUDIT FINDINGS

To accomplish the audit objective, the OIG reviewed and tested selected internal controls related to cost allocation, derivative income, general ledger and financial controls, contracts, employee benefits, budgeting and management reports, fixed assets, disbursements and credit cards, accrued expenses, and a limited review of payroll.

Based on our testing of the grantee's cash disbursements we found that for the most part the internal controls in place at the time of our audit visit were adequately designed and properly working, but there were some weaknesses. While many of DPLS's controls were adequately designed and properly implemented as the controls related to specific grantee operations and oversight, some controls need strengthening while others need to be formalized in writing.

COST ALLOCATION

The grantee has a reasonable cost allocation policy in its Accounting Manual which conforms to the requirements of the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide. However, the OIG reviewed the grantee's cost allocation practice and determined that the grantee did not follow their written policies and procedures. As a result, the grantee did not allocate all indirect costs in accordance with their policy or in a fair and consistent basis.

Allocation Not in Accordance with Policy

1. *Indirect Salaries*

The OIG found that indirect salaries were almost totally allocated to LSC and not shared with other funding sources. We examined the December 2015 and February 2016 indirect salaries allocations and found that 100 percent of the December 2015 indirect salary amount totaling $51,422.40 was allocated to LSC and 98.9 percent of the indirect salary amount for February 2016, totaling $47,114.04, was also allocated to LSC.

The cost allocation policy in the DPLS Accounting Manual states that:

> Indirect and shared expenses will be allocated among funding sources as indicated in the approved budget. The Fiscal Manager and Administrative Director or Project Director will review individual funding source expenditures at least quarterly to determine that expenses have not been exceeded and are within the allowable parameters of the grant. From the above analysis, allocations will be based on percentages established by FTE, percentage of income and/or square footage for each funding source. All costs incurred will be expensed either directly or by Distribution Code in the SOLOMON system

The LSC *Fundamental Criteria*, Section 3-5.9, stipulates:

> common expenses should be allocated among the funding sources on the basis agreed to by the applicable funding organizations, and in the absence of approved methods the allocation should be fair, consistent and apportioned in an equitable manner to the individual cost centers and funds. Further, the allocation formula should be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO, and others, to easily understand, follow, and test the formula. The allocation methodology should be reviewed and assessed as to whether it fairly represents the total cost of the activity.

The OIG does not believe that allocating virtually the entire amount of indirect salaries to LSC is fair and equitable, especially when other funding sources accept indirect costs.

The Director of Finance stated that they allocated almost all of the indirect salary expense to LSC funds because LSC allowed it and he did not want to deplete other smaller grants for indirect costs.

The OIG performed a calculation to determine the amount that should have been allocated to LSC based on the cost schedules used by the grantee. Those schedules stated that based on FTE's, only 68.89 percent of the indirect salary amount should have been allocated to LSC; and based on that rate, LSC should have been allocated $35,424 and $32,456 in December 2015 and February 2016, respectively. The OIG believes LSC was over allocated $15,998 in December 2015 and $14,179 in February 2016.

Since indirect salaries were not allocated to LSC in a manner that is fair and equitable, the OIG is questioning a total of $30,177 for the two months that we sampled. As a result, the questioned indirect salary costs will be referred to LSC management for review and action.

2. Other Indirect Costs

The OIG's review and testing of other indirect costs determined that the grantee is not consistently allocating these costs in accordance with their policy. The OIG judgmentally selected 10 transactions that appeared to be common costs that should be spread out among the various funding sources. Of those 10 transactions, six totaling $4,277.90 were allocated in accordance with the grantee's allocation methodology, however, four totaling $39,398.15 were not.

LSC OIG recalculated the allocation based on the grantee's written policy and determined that in one of the four transactions that were not allocated in accordance with the grantee's cost allocation policy, LSC received less indirect cost than it should have, totaling $623.71. However, in the other three transactions LSC received a combined greater share of the indirect cost resulting in $2,437.12 in excess indirect charges to LSC.

Furthermore, the OIG did not find any documentation to support the reasons that the grantee deviated from their established cost allocation schedule. However, the Director of Finance stated that he decided to allocate indirect cost in a greater proportion to LSC so that the other grants did not have to absorb those costs.

The Director of Finance also stated that due to the limited functionality of the current accounting system, the grantee has had a difficult time maintaining fair and consistent cost distributions to all the funding sources. He asserted that the grantee purchased a new accounting system, Abila MIP, in March 2016, which will address the issues with cost allocation. The accounting system was scheduled to be fully implemented by July 2016.

Failure to follow established cost allocation procedures may result in unfair and inconsistent allocation of expenditures across various funding sources. Without a consistent and systematic basis for allocating indirect costs, there is no assurance that LSC and the other funding sources will receive only their fair and equitable share of the costs.

Since a portion of the indirect costs were not allocated in accordance with the grantee's policy, and not fairly and equitably apportioned in accordance with LSC's guidance, the OIG is questioning a total of $2,437.12 resulting from those questionable transactions. As a result, the questioned indirect costs will be referred to LSC management for review and action.

Recommendation 1: The Executive Director should ensure the accounting staff adheres to DPLS approved and established cost allocation policies and procedures detailed in its Accounting Manual.

DERIVATIVE INCOME

The OIG examined policies and practices related to DPLS's derivative income, including attorneys' fees, during the audit period and determined that the grantee's written policies for derivative income should be strengthened. The OIG found that the practices in place related to derivative income, particularly investment income and attorneys' fees do not fully adhere to LSC guidelines.

<u>Inadequate Attorneys' Fees Policy</u>

The grantee's written policy on attorneys' fees does not describe a detailed methodology outlining the basis of allocating attorneys' fees to the available funding sources. The allocation should be based on attorney time charged to the various funding sources for a case. The Director of Finance stated that he was not aware that the written policy required such detail. Also, the OIG found that the grantee's practice does not reflect this allocation requirement.

45 CFR §1609.6 provides that each grantee shall adopt written policies and procedures to guide its staff in complying with the regulation and shall maintain records sufficient to document the grantee's compliance with the regulation.

Without detailed written policies and procedures, there could be a lack of transparency and consistency in the allocation of the attorneys' fees process, especially in cases of staff turnover.

<u>Attorneys' Fees Allocation</u>

The grantee's attorneys' fees allocation practice is not in conformity with LSC regulations. The grantee allocates all attorneys' fees awarded for cases based on the primary funder of the case. The fees earned on a case are all allocated to the funding source with the majority of hours charged, instead of being allocated in proportion to the hours charged to the funding sources by the attorneys working on the case as required by LSC regulation.

During the period under review, the grantee received 25 court awarded attorneys' fees, totaling $40,686.73. The OIG reviewed a sample of nine transactions totaling $26,829.09. In three of the nine cases, totaling $11,927.50, attorneys who worked on those cases charged time to LSC. LSC was not the primary funder on any of these three cases and did not receive any of the attorneys' fees. For the remaining 16 attorneys' fees transactions that were not in our sample, it was determined that all of those fees were awarded to LSC.

Based on the LSC regulations, the OIG estimated that $1,981.75 of attorneys' fees from these three transactions should have been allocated to LSC. While the OIG was on-site, the Director of Finance made the appropriate adjusting journal entries to credit $1,981.75 to LSC funds.

45 CFR §1609.4 provides that:

> (a) Attorneys' fees received by a recipient for representation supported in whole or in part with funds provided by the Corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of Corporation funds expended bears to the total amount expended by the recipient to support the representation.

Properly recording attorneys' fees in accordance with LSC regulations allows LSC to be allocated its apportioned share, which in turn can be used to provide legal services in accordance with LSC requirements.

Investment Income

The OIG found that although the grantee has an adequate written policy on investment income, which is in conformity with LSC regulations, the policy is not practiced. The grantee received $13,444.14 in fiscal year 2015 and allocated all of the investment income (interest, dividends) to an unrestricted revenue account.

In addition, the grantee earned an additional $13,226.95 on its investment account due to a sale of some of the investment funds in November 2015. None of the gain was recorded as LSC revenue.

The grantee did not maintain records to show the source of funds that make up the investment account balance, and whether they were LSC or non-LSC funds. The OIG estimated that a total $19,451.23 of the investment income and realized gain should be allocated to LSC based on the ratio of LSC grants revenue to the total grant revenue for the year 2015.

While the OIG was on-site, the Director of Finance made an adjusting entry to record the funds against the LSC revenue account for the $19,451.23 based on the OIG's discussions with him on the issue.

45 CFR§1630.12 (a) states:

> Derivative income resulting from an activity supported in whole or in part with funds provided by the corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of corporation funds expended bears to the total amount expended by the recipient to support the activity.

The Director of Finance stated that the practice in place before he arrived was to record the investment income to the unrestricted general fund account and he followed that practice.

Failure to have an adequate allocation methodology for investment income may result in an unfair allocation of investment income back to the appropriate funding sources.

Recommendations: The Executive Director should:

Recommendation 2: update the attorneys' fees policy to fully conform to 45 CFR §1609.4, and ensure that attorneys' fees are allocated in accordance with the regulation, including calculating attorneys' fees based on the proportion of hours charged to funding sources on a particular case.

Recommendation 3: ensure investment income is allocated among funding sources in accordance with the requirements specified in 45 CFR § 1630.12 and the grantee's written policy.

GENERAL LEDGER & FINANCIAL CONTROLS

Inadequate Accounting System Access Controls

Our review of the grantee's accounting system found that user rights and permissions are not adequately segregated. DPLS' accounting staff of three, including the Fiscal Manager, Assistant Fiscal Manager, and the Accounting Clerk, share unrestricted access to the modules and functions within the entire accounting system, through the "SYSADMIN" username. Furthermore, organization-wide, the grantee has a total of eleven usernames within its accounting system with unrestricted access. These users include contractors, consultants, and former employees. Because so many employees are using the "SYSADMIN" user name, a credible audit trail and identification of who was involved with the initial entry, edits or deletions of accounting data cannot be determined.

The LSC *Fundamental Criteria* provides that each grantee must develop security controls that provide assurances that computer and the data they contain are properly protected against theft, loss, unauthorized access, and natural disaster.

The Fiscal Manager stated that the previous management had instructed the accounting staff to share the usernames and it has been a practice of the grantee for a long time. The Director of Finance could not explain why the contractors and consultants were granted access, and why the usernames of the former employees have not been deleted. Management did not evaluate the user access levels needed in the accounting system or make the necessary adjustments to ensure proper internal controls were in place.

Assigning specific logon identifications to the accounting system, limiting user rights to only required functions and authorized personnel and having the ability to produce an audit trail of who made entries to the accounting system reduces the potential for fraud or erroneous entries to occur and not be detected.

Outstanding Checks Policy

The Grantee’s outstanding checks policy needs updating. The Accounting Manual states that outstanding checks greater than six months old should be investigated to determine why they have not been cashed. In practice, only checks outstanding for a year or longer are investigated.

Section 3-4 of the LSC Accounting Guide, Internal Control Structure, provides that 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*.

According to the Fiscal Manager, DPLS practice of only investigating and voiding checks that have been outstanding for over a year is a long time practice by the grantee. Without detailed up-to-date written policies and procedures there could be a lack of transparency and consistency in the application of the reconciliation process, especially in cases of staff turnover. In addition, by delaying the resolution of outstanding checks over six months old, potential frauds or errors would not be detected in a timely manner.

Recommendations: The Executive Director should:

Recommendation 4: enforce the grantee's own written policies and procedures related to handling outstanding checks.

Recommendation 5: ensure that user rights within the accounting system are adequately segregated and each individual authorized to use the system has their own separate, assigned user name and appropriate rights within the accounting system.

CONTRACTS

Contracting Policy Needs Updating

The OIG examined DPLS’ policies and procedures related to business arrangements during the audit period and determined that the contracting policy in the grantee’s accounting manual did not have all the elements contained in the LSC *Fundamental Criteria*. Those missing elements included contracting procedures for different types of contracts, competition requirements, documentation retention, and required approvals.

The Executive Director stated that management was not aware that all of those missing elements should have been included in the grantee's Accounting Manual.

Lack of Contract Documentation and File Maintenance

The OIG tested all six of the contracts the grantee presented to us and found that:

- Five of the contracts did not have:
    - a documented process for the contract actions,
    - selection documentation, or
    - evidence of competition and/or sole source justification.
- Contracts and related documentation were not centrally filed.

The main reason for all of these deficiencies was because the grantee did not have an adequate written contracting policy or practice in place.

The LSC *Fundamental Criteria* stipulates that the process for each contract action should be documented and maintained in a central file. Any deviation from the approved contracting process should be fully documented, approved and maintained in the contract file. In addition, the documents to support competition should be retained and kept with the contract files.

The Executive Director stated that the department heads are required to maintain the contract actions for services they were involved in procuring, therefore contract actions are usually filed with the department heads, not centrally. He added that management was not aware of the requirement to maintain all contract documentation centrally.

The Director of Information Technology stated that some of the contracts were competed but he was not aware of the LSC requirement to retain supporting documentation for competition, thus, he did not retain the documentation. Proper documentation helps ensure that the approved contracting action has followed all established procedures. Without a centralized filing system, grantee's contracting process could be subject to inconsistencies and non-uniformity. It could also result in loss of contracting documentation and non-compliance with LSC requirements on contract maintenance. Also, by not documenting the contract actions, including justification for selection of vendors and the reason the contracts were not subject to competition, it is not clear whether the grantee received the best price and services available for the money spent. Competition helps ensure the best value for the grantee and retaining documentation of the bidding process will establish that the grantee has received the best value and price.

Recommendations: The Executive Director should:

Recommendation 6: establish a written contracting policy that addresses all of the elements required by the LSC *Fundamental Criteria*.

Recommendation 7: ensure that the process for each contract action is fully documented such as sole source justification and documentation of competition, if competitively bid. Documents should also be maintained in the central file.

EMPLOYEE BENEFITS

The OIG's review of employee benefits found that the grantee has an employee housing rental program, but no corresponding written policy detailing that program. Moreover, rental agreements are not established with tenants. We also found that the child care reimbursement policy needs strengthening.

No Employee Housing Rental Policy

The grantee offers limited rental housing to employees to benefit individuals who are not able to find housing near their assigned work location. The Executive Director stated that at times it is difficult to find decent housing on the Navajo Nation Reservation and in order to retain talented individuals; the grantee sometimes offers this benefit to help the individuals meet their housing needs if units are available. The units are generally trailers and the employee pays a monthly rent to live there.

DPLS has no written policy in their personnel or accounting manuals to describe the provisions of this benefit and how it is to be administered.

Section 3-4 of the LSC Accounting Guide, Internal Control Structure, provides that 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*.

Without detailed written policies and procedures, there could be a lack of transparency and consistency in the application of the employee housing process, especially in cases of staff turnover.

No Formal Written Rental Agreements

DPLS does not enter into written agreements with employees who rent dwellings from the grantee. The OIG found that the grantee has six rental properties available. Properties include trailers and apartments and the rent is set at a flat rate of $150 per month, irrespective of the property. During the period under review, the OIG noted that all six of the properties were rented out at some point in time.

The LSC *Fundamental Criteria* provide that the contracts should be fully documented and the documentation maintained in a central file.

The grantee's Director of Facilities did not provide a reason for lack of written rental agreements. He confirmed that the grantee does not have rental agreements with any of the employees who were approved to rent residential units. He added that the previous Administrative Director had authority to offer the rental properties to potential new hires as an incentive for them to work at DPLS. In a recent Board meeting, the Board has approved a rent increase for these properties. The new rates will be raised to $250 per month.

In order to protect the grantee from possible financial liability and to ensure their property rights, the following terms of the rental agreement need to be in writing:

- the length of the tenancy;
- the amount of rent and deposits the tenant must pay;
- the number of people who can live on the rental property;
- who pays for utilities;
- whether the tenant may have pets;
- whether the tenant may sublet the property; and
- the landlord's access to the rental property.

Child Care Reimbursement Policy Needs Strengthening

The grantee’s policy related to child care reimbursement needs strengthening because it does not provide a predetermined rate or set a limit allowed for reimbursement. The grantee’s policy states that DPLS will reimburse employees for reasonable child care expenses for children under the age of 18 incurred during mandatory meetings or training. Currently, the employees inform the management of how much they pay the child care provider. Management then reimburses the employee based on that amount. The policy does not state any maximum allowable amounts. The OIG also found that the child care reimbursement policy does not have a clear definition of “mandatory meetings” which is a requirement for reimbursement.

The Executive Director stated that the grantee believed the written policy was sufficient and did not know it needed to be more detailed.

Without clear and specific written policies and procedures in place, disbursements may be initiated and recorded that would be inconsistent with management intentions or possibly laws or grant restrictions. Clear and specific written policies and procedures also serve as a method to document the design of controls and to communicate the controls to the staff.

The OIG did not investigate any possible tax consequences that could result from the grantee reimbursing employees for child care expenses incurred. The grantee should consult their tax advisors to ensure they are fully aware of all the tax implications of this benefit.

Recommendations: The Executive Director should:

Recommendation 8: develop an employee housing rental policy and ensure it is documented in the grantee's Personnel Manual or Accounting Manual.

Recommendation 9: establish written rental agreements with each of the employees who are approved to rent residential space from the grantee.

Recommendation 10: strengthen the grantee policy over child care reimbursements to define reimbursement amounts and adequately define the term “mandatory meeting”.

BUDGETING & MANAGEMENT REPORTS

Policy Needs Updating

The OIG’s review of the grantee’s policies and procedures as they relate to the budgeting process found that the grantee's budget policy is inconsistent with the practice in the following areas:

- The grantee does not prepare monthly reporting, as stated in their Accounting Manual. Instead, reports are prepared quarterly for the Board.
- Budget vs. Actual (variance) reports are not prepared.
- The annual budget is not formulated as provided for in the grantee’s Accounting Manual.
- The annual budget is not approved by the Board, as stipulated in the grantee’s Accounting Manual.

According to the Director of Finance the current practices have been in place since before he arrived and have not been changed.

Lack of Variance Reports

The OIG’s review of the grantee’s practices as they relate to the budgeting process determined that the grantee does not prepare variance reports to compare budgeted amounts versus actual amounts as part of their quarterly reporting process. However, we noted that the grantee as part of their management reporting, prepares balance sheet, and revenues and expenditures reports.

Section 3-5.9 of the LSC Accounting Guide stipulates:

> A cumulative comparison of total actual income and expenses against total budgeted income and expenses should be prepared. Variances both over and under should be identified on the face of the report.

In discussion with the grantee’s management, they stated that these reports have never been produced and were unaware of the fact that these reports were required by LSC. The lack of such reports may allow budgetary problems and/or shortfalls to not be identified timely and to continue unnoticed.

Annual Budget

The OIG’s review of the grantee’s annual budgeting process found that the grantee currently does not have an annual budgeting process in place requiring the Board of Directors to review and approve a budget for the upcoming fiscal year.

Section 3-5.10 of the LSC Accounting Guide provides:

> The budgeting process should be organized, involve top management, and be closely tied to the goals and priority setting process of the recipient. The budget should be built from cost center/function and "rolled-up" to create the total budget. Schedules should document the assumptions made in arriving at the final cost center/functional budgets.

According to the Director of Finance who arrived in 2014, there is a policy in the Accounting Manual saying that annual budgets should be prepared and approved. Traditionally the grantee has not prepared annual budgets for board approval. Budgeting and projecting are key tools that should be utilized by management to adequately control and plan the expenditures of the program.

Recommendations: The Executive Director should:

Recommendation 11: ensure that the written policies in the DPLS Accounting Manual related to budgeting and reporting accurately reflect what is done in practice and make the necessary changes.

Recommendation 12: require his staff to prepare variance reports as part of the quarterly reporting process.

Recommendation 13: follow their written policy and prepare an annual budget, document the assumptions, get top management involved and obtain approval from their Board of Directors.

FIXED ASSETS

The OIG reviewed the grantee's internal controls over capitalized and non-capitalized fixed assets, including electronic items, and determined that some of the controls needed improvement.

Inventory not reconciled to General Ledger

Our review of the inventory process revealed that although the grantee does perform the physical inventory every two years, the results of the physical inventory were not reconciled to the property records.

The grantee's official property record is its depreciation schedule which lists all of the capitalized assets. The grantee does not have a process in place to reconcile the results of the inventory count to the depreciation schedule.

Section 2-2.4 of the LSC Accounting Guide, Property, provides:

> For property control purposes, a physical inventory should be taken and the results reconciled with the property records at least once every 2 years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference, and the accounting records should be reconciled to the results of the physical inventory with an appropriate note included in the financial statements, if determined to be material by the recipient's auditor.

According to the Director of Finance, he believes the physical inventory is to identify and track properties owned at each office location. He explained that the grantee updates the depreciation schedule when a new fixed asset is added or disposed of.

Properly accounting for fixed assets enables the grantee to safeguard and fully account for the assets purchased and support reconciliations so that property balances are accurate. Comparing the physical inventory count to the property records helps identify any assets that needs to be added to or taken off of the property records.

Asset Tagging

The OIG's review of the fixed asset process revealed that the grantee does not tag its property. The OIG interviewed the Director of Finance and Director of Information Technology who both stated that the grantee stopped tagging fixed assets approximately ten years ago. The Director of IT explained that employees would remove the tags, and as a result, the grantee abolished the practice. The Director of Finance who is relatively new stated that since he arrived, the grantee has not tagged property and the previous practice was never reintroduced.

The OIG observed the physical property and verified that consistent with the statements made by the Director of Finance and Director of IT, the majority of the fixed asset items are not tagged. Also, the property records do not have fields assigning tag numbers to the assets.

Section 3-5.4 (c) of the LSC Accounting Guide provides that:

> Property purchases should be recorded in a property subsidiary record. The property record should include description of property, date acquired, check number, original cost, funding source, estimated life, depreciation method identification number and location. In addition, the property subsidiary record must agree with the general ledger property accounts.

Failure to tag assets and maintain adequate property records may result in the inability to fully account for fixed asset purchases and could result in inaccurate property asset balances.

Recommendations: The Executive Director should ensure:

Recommendation 14: that accounting records are reconciled to the results of the physical inventory for property control purposes.

Recommendation 15: that fixed assets are tagged and ensure property records are maintained with the corresponding tag numbers.

DISBURSEMENTS

Lack of Segregation of Duties over Master Vendor List

The OIG found that there is a lack of segregation of duties between the job responsibilities of the employee who maintains the vendor list and their duties related to processing accounts payable.

The Fiscal Manager, who maintains the vendor list, has the primary responsibility for creating new vendors and has the ability to edit vendor information or delete altogether without the review and approval of a management level staff. She also performs accounts payable responsibilities that include initiating and processing payments.

In addition, DPLS does not have management oversight for establishing, vetting, and approving new vendors.

The Accounting Guide states:

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

The Director of Finance asserted that it has been difficult for the grantee to establish adequate segregation of duties because the accounting department is currently short staffed.

A lack of segregation of duties over the master vendor list may result in unauthorized or fraudulent payments to vendors.

Lack of Written Prior Approval for Travel

Our review of travel transactions found that the grantee does not have a formal prior approval process for staff travel related to meetings, conferences, and/or training.

The OIG reviewed 17 instances of reimbursements related to staff travel, and none of them had prior written approval. According to the Director of Finance, there is no prior approval process in place for employee travel. Some employees do receive travel advances for upcoming trip costs. However, there is no formal written approval of the trip itself.

Section 3-5.4 of the LSC *Fundamental Criteria*, Cash Disbursements states:

> Approval should be required at an appropriate level of management before a commitment of resources is made. In addition, the receipt of goods and accuracy of invoices should be verified and documented.

The Director of Finance could not provide a reason as to why prior approval was not required other than that it has been the grantee's practice ever since he has assumed the responsibilities in his current position.

Failure to have a prior approval process may result in unauthorized travel and related expenses paid for by the grantee. Also, the prices and terms of the related expenses may not be the best available for that travel.

Lack of Supporting Documentation for Travel

Of the seventeen reimbursements tested related for travel, the OIG did not find proof of attendance to support reimbursements in four cases totaling $933.05. The Director of Finance explained that the grantee does not require proof of attendance to support travel reimbursements. The LSC Accounting Guide provides that disbursements should be supported by adequate documentation, including receipt of goods and the accuracy of invoices should be verified. Without adequate documentation and internal verification, cash may be disbursed for goods and services not received, in advance of receipt, or in the wrong amount.

Untimely Travel Reconciliations

The OIG noted that the reconciliation of travel advances to travel expense reports are not performed timely in accordance with DPLS policy. We reviewed three months of reconciliations, specifically, October, November, and December of 2015. We found that two travel advances were awarded in October 2015 and have not been reconciled as of the date of this audit. In two out of eight instances, employees submitted a travel expense report more than four months after the travel occurred.

DPLS Personnel Manual, B. Advances, provides:

> Advances must be reported on a Travel Expense Statement and cleared within 30 days of completion of travel or the amount of advanced will be deducted from the employee's next paycheck and not reimbursed. Accounting will send notification to any employee that has an outstanding advance at least 2 weeks before any income withholding to allow the employee to clear the advance.

The Fiscal Manager stated that the accounting department sends reminders to employees but some of the employees are noted for not submitting their expense reports on time. In addition, she explained that she has not had a chance to track open travel advances from January 2016 to date because of the amount of responsibilities that are taking precedence at the moment.

By not reconciling travel expense reports to travel advances, the grantee may have paid for anticipated expenses that the employee did not incur during a trip. Also, amounts due to the grantee or employee are not determined and paid timely.

Recommendations: The Executive Director should:

Recommendation 16: establish a policy over the administration of the master vendor list to ensure there is adequate segregation of accounting and record keeping duties.

Recommendation 17: include a formal written prior approval process for staff travel and require submission of all supporting documentation for the attendance at meetings, conferences, or training.

Recommendation 18: enforce the provisions of the grantee's written travel advance policy requiring travel expense statements to be cleared within 30 days of completion of travel.

ACCRUED EXPENSES

Written Policy Needs Updating

In the OIG's review of the grantee's Accounting Manual, we noted a passage in the accounting manual with respect to the accrual of expenses that we believe is not in accordance with Generally Accepted Accounting Principles (GAAP).

The passage from the Accounting Manual states:

> In order to produce monthly financial statements in a timely manner, all invoices received after the 10th of each month for the previous month will be accounted for in the current month. In other words, an October invoice received on the 10th of November will be treated as a November expense.

This policy implies that invoices received after the 10th of the month will be treated as expenses of the month the invoice was received instead of when the expense actually incurred is contrary to accrual based GAAP.

Section 2-1.1 of the LSC's Accounting Guide provides:

> In general, LSC requires recipients and subrecipients (hereinafter recipients) of its funding to: (1) manage LSC and non-LSC funds in a stewardship manner and pursuant to the cost standards and procedures of 45 CFR § 1630; and (2) record transactions in accounting records and prepare annual financial statements in accordance with GAAP.

In addition, the LSC Accounting Guide provides that each grantee must develop a written accounting manual that describes the specific procedures to be followed by the recipient in complying with the *Fundamental Criteria.* According to the current Director of Finance, the prior Director of Finance may have followed that practice. However, he stated that currently he accrues expenses in accordance with the guidelines provided by GAAP. As such, according to him that passage in the Accounting Manual can be eliminated or rewritten.

By not following GAAP accounting practices the grantee would be in violation of LSC requirements as stated in the Accounting Guide.

Recommendation 19: The Executive Director should remove the questionable passage from their Accounting Manual; or update the passage with wording that is in accordance with GAAP.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with all findings in the report and accepted all nineteen recommendations. Grantee management's formal comments can be found in Appendix II.

OIG EVALUATION OF GRANTEE COMMENTS

The OIG considers the proposed actions to address Recommendations 1 through 19 as responsive. The actions planned by grantee management to address the issues and revise and update its Accounting Manual should correct the issues identified in the report.

However, Recommendations 2, 3, 6, 8, 10 and 11 will remain open until the grantee has drafted the respective policies, revised its Accounting Manual and obtained the required Board of Directors' approval.

Recommendation 1 will remain open until the grantee and the consultant have completed their review of the cost allocation process, and until LSC management has addressed costs questioned by the OIG of $30,177 related to indirect salaries and $2,437 related to other indirect costs.

Recommendations 5 and 16 will remain open until the OIG receives updated user rights documentation from the grantee confirming that accounting system access has been adequately segregated in the accounting department and over the master vendor list.

Recommendation 7 will remain open until the grantee notifies the OIG that it has implemented the proposed contract filing system and has stored all grant and contractual documentation on a shared drive as stated in their response.

The grantee has completed an employee rental agreement form; however, Recommendation 9 will remain open until the grantee provides the OIG documentation showing it has established written agreements with employees who rent housing.

With respect to budgeting and management reporting, Recommendations 12 and 13 will remain open until the grantee provides the OIG with documentation showing that variance reports are being prepared and that the grantee prepares an annual budget.

Recommendations 14 and 15 will remain open until the grantee has provided the OIG documentation showing that the results of the physical inventory have been reconciled to the general ledger and that fixed assets are being tagged.

Finally, Recommendation 19 will remain open until the OIG has received notification that the training on accrued expenses has been completed and the accrued expense policy has been updated.

Recommendations 4, 17 and 18 are considered closed. The grantee has adequately addressed the outstanding check issue. They have also established and communicated to staff prior approval requirements for travel, requirements for timely submission of travel documentation and requirements for the timely completion of travel expense reports.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Derivative Income,
- Contracting,
- Cost Allocation,
- Fixed Assets,
- Internal Management Reporting and Budgeting,
- General Ledger and Financial Controls,
- Disbursements,
- Credit Cards,
- Employee Benefits and
- Payroll.

To obtain an understanding of the internal controls over the areas reviewed, grantee policies, and procedures were reviewed including manuals, guidelines, memoranda and directives, setting forth current grantee practices. Grantee officials were interviewed to obtain an understanding of the internal control framework, and management and staff were interviewed as to their knowledge and understanding of the processes in place. To review and evaluate internal controls, the grantee's internal control system and processes were compared to the guidelines in the *Fundamental Criteria of an Accounting and Financial Reporting System* (*Fundamental Criteria*) contained in the LSC Accounting Guide. This review was limited in scope and not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

We assessed the reliability of computer generated data the grantee provided by reviewing available supporting documentation for review, conducting interviews, and making physical observations to determine data consistency and reasonableness. We determined the data was sufficiently reliable for the purposes of this report.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the grantee's Procedures Guide. We interviewed appropriate program personnel and performed recalculations of some revenue accounts.

To evaluate the adequacy of the cost allocation process, we discussed the scope period with grantee management and requested the grantees written cost allocation policies and procedures for review, as required by the LSC Accounting Guide. We tested the cost allocation amounts and reviewed the related reclassification entries using the information provided by the grantee.

To evaluate and test internal controls over contracting, fixed assets, internal management reporting and budgeting, general ledger and financial controls and payroll, we interviewed appropriate program personnel, examined related policies and procedures and selected specific transactions to review for adequacy. We performed detailed disbursements testing by judgmentally selecting a sample of 92 disbursements from 67 vendors. We reviewed supporting documentation, approvals and the appropriateness of each disbursement.

The on-site fieldwork was conducted from May 3 to May 11, 2016. Our work was conducted at the grantee's office in Window Rock, Arizona and at LSC headquarters in Washington, DC. We reviewed documents pertaining primarily to the period January 1, 2015 through February 29, 2016.

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

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September 27, 2016,

John M. Seeba, Assistant Inspector General of Audit
Office of Inspector General
Legal Services Corporation
3333 K St. NW
Washington, D.C. 20007

RE: DNA Comments on LSC – OIG Draft Report on Audit of Selected Internal Controls

Dear Mr. Seeba:

In response to the LSC OIG Draft Report on Audit of Selected Internal Controls, DNA submits the following responses on the draft report:

A. Cost Allocation

1) Indirect Salaries and Other Indirect Costs

The Director of Finance, Development Director, Contracts & Grants Manager, Project Director(s) and Accounting Staff will review time and billing reports, contractual agreements, and budgets to determine which grants allow indirect salaries and common expenses that can be allocated to these grants. Per time and billing reports, and the number of FTEs at DNA will also be used to determine allocating direct and indirect salaries (where allowed). Common expenses such as occupancy expenses, utilities, building maintenance and repairs, and other costs associated with facilities will utilize the square footage of DNA buildings and offices as a cost basis to allocate expenses properly to the appropriate grants on a proportionate and reasonable basis, non-facility related expenses will use FTEs to determine costs to be allocated. The current allocation plan will be reviewed and revised to ensure that all costs are allocated in a fair and equitable manner. The allocation methodology will be documented in sufficient detail. Lastly, DNA has retained the services of a Navajo CPA to assist DNA with updates on accounting, auditing and policy related issues, and to provide training on internal controls and segregation of duties.

B. Derivative Income

1) Inadequate Attorney's Fees Policy

The former Human Resources Director/Director of Administration prepared a draft revision attorney fees policy (attached), but is has not been finalized yet since it is still under review and comment. The draft policy was issued on June 8, 2016.

2) Attorney's Fees Allocation

   Following is proposed language to be included in the draft revision of the attorney fees policy in regards to attorney's fees allocation. "When DNA receives attorneys' fees for a case, the money will be deposited into the LSC or appropriate private funds account within one week of receipt of the attorneys' fees. DNA accounting will require the Litigator to provide a case number to verify time and billing hours in the DNA Case Management System and deposit the attorney fees into the appropriate grant, if the attorney fees were generated under various grants, the fees will be allocated proportionately per time and billing hours. The attorney fees can then be used as any other LSC or private funds may be used (in other words, they are restricted funds)."

3) Investment Income

   DNA will allocate investment income proportionately in the amount that LSC funds are expended to the total amount of all DNA funds expended. The Director of Finance will review DNA investment statements on a quarterly basis and make the appropriate adjusting journal entries to record gains and losses and allocate it proportionately per review of DNA quarterly income and expenditure reports. The derivative income policy will be updated accordingly on the allocation of derivative income.

C. General Ledger & Financial Controls

1) Inadequate Accounting System Access Controls

   Per LSC OIG auditor's recommendations the Director of Finance, with the assistance of the MIP consultant, created separate user accounts and passwords for each authorized user in the accounting office with access to MIP. User rights and access to various modules in MIP was determined based upon the employee's current job duties and responsibilities. The Director of Finance is the only accounting staff member who can change and authorize which accounting modules an employee can have access to. This was corrected on-site during the LSC OIG audit visit, and documentation of the MIP user list was provided to the auditors.

2) Outstanding Checks Policy

   During the FY 2015 financial statement audit all outstanding checks more than six months old were voided and reversed in the accounting system by the Fiscal Manager. The Fiscal Manager now monitors for any outstanding checks that are more than 90 days old and will notify the payee and determine the reason(s) for the check still being uncashed, and will then determine whether the check will need to be voided and re-issued. The bank reconciliation policy will be updated to change the outstanding checks from the current 6 months to 90 days.

D. Contracts

1) Contracting Policy Needs Updating

   Per the recommendations of the LSC OIG Auditors DNA will develop a contracting policy using the LSC Fundamental Criteria as a guide. The policy will identify contracting procedures, contract types, dollar thresholds, bidding/competition requirements, sole sourcing, and required approval levels. The policy will also ensure the process for procuring services under a contract will be documented and maintained in a central file location. The Director of Finance, Executive Director and the Board of Directors Budget and Audit Committees will all be involved in the development of the policy.

2) Lack of Contract Documentation and File Maintenance

The Director of Finance, Contracts & Grants Manager, Development Officer, and Executive Assistant will coordinate and implement a filing system; and ensure that all grant and contractual agreements are maintained and stored in a share drive that is accessible to DNA management and auditors.

E. Employee Benefits

1) No Employee Housing Rental Policy

The Executive Director and Facilities Maintenance Manager, in consultation with DNA staff attorneys will develop an employee housing rental policy that addresses the six DNA owned properties that it leases to its employees. The policy will include assignment of property, occupancy, lessee/lessor responsibilities, termination/appeal of eviction, prohibited activities, safety, maintenance, utilities, rental/other fees, cleaning/security deposits, pets, etc. The Facilities Maintenance Manager is currently researching employee rental policies and working with a DNA litigator/advocate with experience in public rental housing policy in developing DNA's employee rental policy.

2) No Formal Written Rental Agreements

The former Human Resources Director/Director of Administration had drafted a written rental agreement (attached) that the Facilities Maintenance Manager used to enter into a rental agreement with an employee who resides in a DNA owned mobile home in Ft. Defiance, AZ. The Executive Director reviewed the agreement and approved its use in June 2016.

3) Child Care Reimbursement Policy Needs Strengthening

The Human Resources Director and Director of Finance will review and revise the current child care costs policy. Current policy reimburses reasonable child care expenses for children under 18 years old and to the extent expenses are in excess of an employee's ordinary child care costs. The proposed child care expense will reimburse a DNA employee's child care costs up to a maximum of $25 per child in excess of their ordinary child care costs. In addition the age of the child will be changed from under 18 years old to 13 years old in accordance with IRS Publication 503. DNA will also define mandatory meetings/training as events that have a program wide effect on all employees. Such meetings/trainings will include updates on changes in DNA policies, training such as sexual harassment, changes in labor laws, new employee orientation, audit and grantor compliance related matters, and on directives issued by the Board of Directors.

F. Budgeting and Management Reports

1) Policy Needs Updating

DNA purchased Abila MIP Fund Accounting Software, which includes a budgeting module, in October 2015. The software was installed and implemented in the early part of 2016 and went 100% live on May 23, 2016 in MIP. Prior to purchasing MIP DNA used a commercial type accounting software where budgets relative to fund accounting could not be entered and reliable budget reports could not be generated or reported on. Abila MIP will now allow DNA to enter budgets for the various grants it receives, which will allow for a budgeting process to occur. The Director of Finance and Board of Directors Budget Committee will revise and implement a budget policy that aligns with its strategic initiatives.

2) Lack of Variance Reports

In June 2016 the Director of Finance and MIP consultant were able to develop a spreadsheet template to develop budgets in a spreadsheet and import it into MIP. Currently, DNA has completed seven budgets for import, including all LSC grant awards. With the implementation of MIP, DNA now has the ability to generate variance reports that compares budgeted amounts to actual amounts.

3) Annual Budget

DNA management is planning to have budget meetings with staff to review revenue and expenditures for FY 2016 and start the budgeting process in late October and part of November 2016. The plans are to develop a budget for all DNA offices and have it approved by the Board of Directors. Since DNA purchased MIP, the accounting staff is now able to directly input budgets and cost allocation percentages using distribution codes in MIP to allocate costs, encumber expenses, and is flexible enough where staff can monitor grant revenues and expenditures over the various overlapping fiscal year cycles. DNA management plans to develop and implement an annual budget for FY 2017. The Board of Directors Budget Committee will also be involved in the formulation of an annual budget for presentation and approval by the Board of Directors.

G. Fixed Assets

1) Inventory not reconciled to General Ledger

The Director of Finance, Purchasing Clerk, and accounting staff will work on reconciling purchases to the GL once an item that needs to be tagged is received and accounted for. The accounting policies and procedures will be updated to ensure that inventory is reconciled and accounted for.

2) Asset Tagging

The Facilities Maintenance Manager and DNA Office Managers will be responsible for taking bi-annual inventory and tagging all DNA fixed assets in excess of $5,000 and sensitive items such as computers, laptops, printers, tablets, servers, video and still cameras, and other electronic equipment or items that are deemed to be of high value and prone to theft.

H. Disbursements

1) Lack of Segregation of Duties over Master Vendor List

Per LSC OIG auditor's recommendations the Director of Finance, with the assistance of the MIP consultant, created separate user accounts and passwords for each authorized user in the accounting office with access to MIP. The Director of Finance is the only accounting who can update vendor information, add new vendors, and delete inactive vendors. This was corrected on-site during the LSC OIG audit visit, and documentation of the MIP user list was provided to the auditors.

2) Lack of Written Prior Approval for Travel

   A memorandum was issued by the Finance Director to all DNA employees on August 11, 2016 (see attached copy) on travel claim issues. A training or review of the travel policy and procedures was provided on August 12, 2016 at the DNA administrative offices in Window Rock, AZ.

3) Lack of Supporting Documentation for Travel

   See item 2 above.

4) Untimely Travel Reconciliations

   During its review of travel related issues with DNA staff on August 12, 2016 the Director of Finance informed DNA staff that all travel expense reports received after 45 days after travel occurs will not be accepted or reimbursed by the accounting office. This is not included in the memorandum dated August 11, but is mentioned in the Travel Policy (attached) as Item K on the last page and is also in bold text on the Travel Expense Statement Form (attached) above the signature lines.

I. Accrued Expenses

1) Policy Needs Updating

   DNA-People's Legal Services, Inc. (DNA) has formally engaged the services of Joaquin Noon, Certified Public Accountant (CPA). Mr. Noon is a member of the Navajo Nation and has substantial experience with over 13 years with a big four accounting firm and two years as a consultant assisting organizations with internal control design and implementation and finding remediation. The Director of Finance will work with the CPA, who will perform the following, including training on accruing expenses:

   a) With the assistance of management, complete the *Accounting Procedures and Internal Control Checklist* in Appendix VII of the Accounting Guide for LSC Recipients 2010 edition.
   b) Using the results of the completed checklist, identify areas for improvement.
   c) Using chapter 3-6 of the Accounting Guide for LSC Recipients 2010 edition as a questionnaire, determine if fraud risks are present in the current processes.
   d) Perform a "gap analysis" to identify improvements in the current processes and possible redundancies using the following:
      - DNA's existing policies and procedures (accounting manual)
      - Identified areas for improvement from the completed checklist
      - Fraud risk(s) identified from the completed questionnaire
      - Findings identified by DNA's independent public accountant (IPA)
   e) Assess the adequacy of the existing policies and procedures.
   f) Develop/enhance policies, procedures, and internal controls based on the results of the "gap analysis."

g) Develop training modules for all accounting staff, placing priority on areas with existing findings.
h) Assist with the close out of the accounting records for the year ended December 31, 2016. The goal of this step being:
   - Reduce/eliminate adjustments identified by the IPA
   - Reduce/eliminate findings identified by the IPA
   - Hands on experience implementing the theories and practices addressed in the training modules

If you have any questions please contact me at (928) 871-4151 Ext. 5630 or Vernon Laughlin, Director of Finance at Ext. 5640.

Sincerely,

Thomas J. Holgate
Executive Director

Attachments