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September 30, 2011

Mr. James A. Ferguson
Executive Director
Legal Services of Northern Virginia, Inc.
6066 Leesburg Pike
Falls Church, VA 22041

Dear Mr. Ferguson:

Enclosed is the Office of Inspector General's final report on the results of our audit on Selected Controls at Legal Services of Northern Virginia. We have reviewed your response to the recommendations in the draft report and believe your proposed actions to address Recommendation 1 through 5 are partially responsive. Your comments did not address Recommendation 6 and are therefore considered nonresponsive. Recommendations 1 through 6 are considered open and will be forwarded to LSC management for resolution.

The full text of your comments is attached to the report as an Appendix. Thank you and your staff for your courtesy and cooperation during this audit.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: James Sandman, President
Legal Services Corporation

LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

LEGAL SERVICES OF NORTHERN VIRGINIA, INC.

RNO 447007

Report No. AU-11-06

September 2011

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 Legal Services of Northern Virginia, Inc. (grantee or LSNV) related to grantee operations and oversight. Audit work was conducted at the grantee's main office in Falls Church, VA and at LSC headquarters in Washington, DC. The on-site fieldwork was conducted on January 24 - 31, 2011. Documents reviewed pertained to the period January 1, 2010 through December 31, 2010.

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

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

OBJECTIVE

The overall audit objective was to assess the adequacy of selected internal controls in place at LSNV 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. In addition, the OIG examined regulatory policies and grantee processes to assess whether controls were designed in a manner expected to ensure compliance with 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, internal management reporting and budgeting, selected LSC regulations, and employee benefits and reimbursements 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. LSNV officials were interviewed to obtain an understanding of the internal control framework and to ascertain their knowledge and understanding of the processes in place. Computer-generated data provided by the grantee was used to determine whether entries recorded in computer systems matched the information contained on the source documents. However, the OIG did not test the general or application controls over the computer generated data because the controls were not considered significant to the audit objective.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample represented about 11 percent of the over $3 million disbursed by the grantee during the period January 1, 2010 through December 31, 2010; and consisted of 88 transactions totaling $326,320. To assess the appropriateness of these expenditures, we reviewed invoices, vendor lists, and general ledger details. The appropriateness of grantee expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance.

To review internal controls over internal management reporting and budgeting, the grantee's system and processes were compared to those detailed in the *Fundamental Criteria* of the Accounting Guide. Controls over employee benefits and reimbursements were reviewed by examining the collective bargaining agreement and other personnel policies and practices, and by testing a judgmentally selected sample of employee reimbursements as part of the disbursements testing.

To review internal controls over compliance with specific LSC regulations (45 CFR Parts 1610, 1612, 1617 and 1627), written compliance policies and procedures were examined, including those based on applicable LSC mandated recordkeeping requirements; applicable documentation and reports were reviewed; and staff members were interviewed. This allowed the OIG to determine if the controls were designed in a manner to ensure compliance with the provisions of the respective LSC regulation.

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.

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.

OVERALL EVALUATION

Internal controls reviewed and tested at LSNV 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 need to be strengthened or formalized. Controls over regulations were designed in a manner expected to ensure compliance with the LSC Act and selected LSC regulations, with one exception.

Grantee disbursements tested were adequately supported, allowable, and appeared 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 Accounting Guide. Internal controls over reimbursements and employee benefits were adequate. Policies over employee benefits practices were adhered to. With the exception of policies governing salary advances, employee benefits policies were in writing.

The following areas were noted where internal controls could be strengthened.

- The grantee's current accounting manual does not contain written policies and procedures governing credit card usage; monitoring of subgranted funds; cost allocation methodology; salary advances; travel and per diem reimbursement limits; internal management reporting and budgeting; and cell phones and electronic devices.

- Fixed assets were not properly managed. Subsidiary records of capitalized equipment and property that were purchased or donated did not include details required by the grantee's accounting manual and LSC's Accounting Guide. The grantee did not affix any unique characteristics or markings on its capitalized assets, which would have made locating and identifying the fixed assets easier. Since its merger with Potomac Legal Aid Services, Inc. (PLAS) in January 2010, the grantee has not conducted a physical count of all capitalized equipment and property.

- Internal controls over compliance with LSC regulations (45 CFR Parts 1610, 1612 and 1617), were adequately designed. However, the grantee has not performed the monitoring of its subgranted funds with

Rappahannock Legal Services as required by the two subgrant agreements and in accordance with LSC regulation 45 CFR Part 1627.3(c).

AUDIT FINDINGS

1. Accounting Manual

LSNV did not have an approved accounting manual in place for the period under audit. To satisfy LSC's requirement that each grantee must develop a written accounting manual in order to establish an adequate internal control structure, LSNV hired a Program Administrator to compile policies and procedures that had been in place prior to the merger with PLAS. According to grantee management, employee turnover delayed the approval of the draft until after the audit period.

The draft accounting manual established the roles and responsibilities for the accounting functions, detailed the activities that were strictly prohibited by the LSC Act, and included many required sections like receipts, investments, and transfers of funds, purchasing, cash disbursements, payroll, reconciliations, petty cash, and general ledger. However, although the procedures already in place were adequate, the draft accounting manual did not incorporate policies governing the use of credit cards, cost allocation methodology, salary advances, travel and per diem reimbursement limits, internal management reporting and budgeting, and cell phones and electronic devices.

Having a current and complete accounting manual helps ensure that proper controls are developed, documented and followed. The accounting manual also serves as a vehicle to communicate controls to all staff and ensures that staff members understand their roles and responsibilities.

Recommendation 1. The Executive Director should ensure that LSNV's accounting manual is updated to incorporate all essential policies and processes as required by the LSC's Accounting Guide.

Grantee Comments. Grantee management agreed with Recommendation 1 and stated in part:

> We appreciate the Draft Report's observation that LSNV already has in place policies governing such important matters as the use of credit cards, cost allocation methodology, salary advances, travel and per diem reimbursement limits, internal management reporting and budgeting, and cell phones and electronic devices. We also recognize the importance of LSNV's Board formally approving these policies as part of LSNV's Accounting Manual. The enumerated subject matters have now been added to the

accounting manual **(see enclosed draft manual)** and it is our intention to present the entire document for approval at the next Board meeting (October 12th).

Grantee management comments also indicated that there were several factors that impacted the process of drafting its accounting manual and delayed approval until after the period under audit (January 1, 2010 through December 31, 2010). The Program Administrator was hired not only to compile policies and procedures for the accounting manual, the Administrator was also put in place to oversee all of the finance and human resources functions. Also, the process of merging the two programs was extremely time-consuming. And finally, LSC's new Accounting Guide was not issued until August 2010. The full text of management's comments is attached to the report as an Appendix.

OIG Evaluation of Grantee Comments. Grantee management comments are partially responsive to Recommendation 1. Management provided a current draft accounting manual with its comments. While the new draft accounting manual did contain policies and procedures for the areas identified in the finding, some essential policies and procedures, which were in the draft accounting manual reviewed during our audit, were omitted. Specifically, the OIG was unable to locate in the current draft accounting manual the grantee's policies and procedures governing tagging of capital acquisitions, taking of physical inventory, and reconciling the results of the inventory to the property records and financial statements. These provisions were contained in Chapter XIX – Accounting for Fixed Assets of the previous draft that was reviewed during the audit. Recommendation 1 will be referred to LSC management as partially non-responsive and remain open until resolved and all actions have been taken.

2. Management of Fixed Assets

Fixed assets were not properly managed. The grantee's subsidiary records of fixed assets did not include some required information. The Accounting Department's (AD) List of Assets did not contain information necessary to locate the fixed asset. The Information Technology Department's (IT) PC Inventory Report, which is designed to augment the AD List of Assets, also did not contain the information necessary to locate IT equipment. Fixed assets could not be easily located or could not be located at all. Finally, since the merger with PLAS in January 2010, a complete inventory has not been conducted.

Subsidiary Records

The subsidiary records for capitalized assets did not include details required by the grantee's accounting manual and LSC's Accounting Guide. The manual required ten key elements of recordkeeping information if the asset was purchased, and twelve if received through donation. The AD List of Assets did not provide five of these elements:

- the check number used to pay for the item;
- the source of the funds used to acquire the property;
- the method of valuation (if the property was received through donation);
- the identification numbers; and
- the location of the asset.

PC Inventory Report

To aid in tracking computers and other electronic equipment issued to grantee personnel, the Technology Manager maintains a listing called the PC Inventory Report. The report is an internally-designed listing intended to keep track of IT assets. According to management, the listing also was used to provide information to update the subsidiary records maintained by the accounting department. The report lists the office and the first name of the equipment user, the type of equipment issued, the date of acquisition, a mark to signify that the item was received through donation, and the equipment's technical specifications.

Because grantee management did not have identification numbers unique to each item of equipment selected for review, we have no assurance that any of the computers physically reviewed were in fact the computers selected from the PC Inventory Report. Of the 13 computers selected for review, 10 were from Falls Church and 3 from Fairfax offices, 1 could not be located and 7 were not configured to the same specifications indicated in the PC Inventory Report. The remaining 5 computers inventoried matched the technical specifications, but without unique identifying numbers we could not say with certainty that these were the computers selected for review. We believe that this may have resulted, in part, because there were no written policies and procedures describing the content or use of the PC Inventory Report.

Location of Fixed Assets

Fixed assets could not be easily located because neither the List of Assets nor the PC Inventory Report contained adequate information. The grantee did not attach to its fixed assets any unique characteristics or markings, such as pre-numbered tags or labels. In some cases, items on the List of Assets were recorded in lots or grouped together which made identifying specific assets nearly impossible. For example, recorded in the List of Assets were *"7 Computers for FC"*, *"Old Unknown F & F"*, or *"6 Monitors."* As a result, the OIG was not able to test the assets listed in the Accounting Department's subsidiary records.

Fixed Assets Inventory

An inventory was not conducted at the time PLAS merged with LSNV. Since the merger, the grantee has not conducted a physical count of all capitalized equipment and property.

The grantee indicated that employment turnovers in both the Program Administrator and the IT Director positions, both of which are responsible for maintaining inventory property records and setting the value of donated fixed assets, contributed to the grantee's problems in managing accounting of fixed assets. However, these personnel were employed for periods of time in which an inventory count could have been conducted, but was not. Therefore, the OIG believes that factors other than employee turnover may have contributed to the conditions identified.

Properly managing fixed assets helps ensure that fixed assets are fully accounted for, adequately safeguarded, and properly reported.

Recommendations: The Executive Director should ensure that:

Recommendation 2. The subsidiary records of all capitalized equipment and property that were purchased or donated are updated to include the details required by the LSNV's Accounting Manual and the LSC Accounting Guide.

Recommendation 3. The information contained in the PC Inventory Report is accurate and reconciled with the subsidiary records; and that written policies and procedures are documented describing the processes to be used to ensure that subsidiary records are accurately updated.

Recommendation 4. Inventory tags or labels are attached to fixed assets for ease of locating and accounting.

Recommendation 5. A physical inventory of all fixed assets is conducted and reconciled to the property records.

Grantee Comments. Grantee management agreed in principle with the findings and recommendations, but expressed concern about the amount of effort and cost required to comply with LSC's requirements for accounting for fixed assets. Management indicated that the assets, many of which were donated, were accumulated over a 30-year period with a significant amount obtained over 10 years ago. Management felt that it would not only be impractical but nearly impossible to add the information required by LSC to the property records.

Management did state that the assets transferred from the prior grantee were fully accounted for and tied to LSNV's general ledger. Management will also review its current inventory and remove any items no longer on hand from its records. In the future, management stated that it would follow LSC's property guidelines. Finally, management stated that processes will be implemented to account for computers, cell phones, and other electronic equipment. The full text of management's comments is attached to the report as an Appendix.

OIG Evaluation of Grantee Comments. Grantee management comments are partially responsive. The actions taken and planned will provide better control over fixed assets and improve accountability. However, some of LSC's requirements will not be met based on management's stated actions. The OIG cannot grant waivers from LSC grant assurances or LSC policies. LSNV can seek relief directly from LSC management. The OIG is concerned that key provisions of the fixed asset management chapter contained in LSNV's June 24, 2010 draft accounting manual have been deleted from the most recent draft provided to the OIG. The deleted provisions, such as attaching of inventory control numbers to fixed assets, taking physical inventory at least every two years and reconciling the results thereof to the property records and financial statements are requirements similar to those contained in the LSC Accounting Guide. As a result, LSNV's ability to adequately safeguard and account for its fixed assets may be at risk. Because, management's comments were only partially responsive, Recommendations 2 through 5 will remain open and the OIG will forward these issues to LSC management for resolution.

3. Monitoring of Subgrants

Legal Services of Northern Virginia has not accomplished the monitoring requirements of the Rappahannock Legal Services (RLS) subgrant agreements. The grantee has two subgrants with RLS totaling $48,000 for PAI services and training. Each of the subgrants contains specific monitoring requirements to be conducted by the grantee. However, the grantee had not performed the monitoring as required. Specifically, the grantee did not receive monthly financial reports from RLS. Also, according to the grantee's Pro-Bono Coordinator, only one of four required onsite visits to RLS occurred during the period of review. Finally, case status was monitored by a quarterly report from RLS rather than by at least a monthly case status update as required by the subgrant agreement.

The grantee stated this issue was caused by the recent appointment of a new Pro-Bono Coordinator. However, the grantee did not have documented policies and procedures describing how the monitoring was to be carried out. The only procedure, explained by the Pro-Bono Coordinator, was that of reviewing the quarterly case status reports and inquiring on potentially delinquent cases.

According to 45 CFR § 1627.3(c), "The recipient is responsible for ensuring the proper expenditure, accounting for, and audit of delegated funds." Properly monitoring subgrant agreements supports this responsibility and helps ensure that LSC funds are used for allowable and agreed to purposes, and that the grantee is receiving the services promised under the subgrant agreements.

Recommendation 6. The Executive Director should ensure that written policies and procedures are developed and implemented requiring that subgrants be monitored in accordance with LSC regulations and subgrant agreements.

Grantee Comments. Grantee management comments did not address Recommendation 6. Specifically, management stated:

> Although the Draft Report is correct about the monitoring requirements of older versions of LSNV's subgrant with RLS, the 2011 version of this subgrant, which was approved by LSC (**see enclosed subgrant agreement**), modified the monitoring requirements so that LSNV only had to review the quarterly case reports – which we are doing. LSNV may have provided the audit team with an outdated version of the subgrant prior to the audit. In any case, the staffs of both programs remain in regular contact with each other regarding the status and proper handling of referrals made under this subgrant.

OIG Evaluation of Grantee Comments. Grantee management comments did not address Recommendation 6 and are therefore considered non-responsive. Whether or not LSC approved the 2011 version of the subgrant is not relevant to the finding. Monitoring of 2010 subgrants was not conducted as specified in the subgrant agreements for 2010. While the 2011 subgrant changed the frequency of the monitoring to be performed, the OIG still recommends that policies and procedures be implemented to ensure that the monitoring is conducted as described in the subgrant agreement. Recommendation 6 is considered open and will be forwarded to LSC management for resolution.

LSNV LEGAL SERVICES OF NORTHERN VIRGINIA

August 29, 2011

Ronald D. Merryman
Assistant Inspector General for Audit
Legal Services Corporation
3333 K Street, NW, 3rd Floor
Washington, DC 20007-3558

Re: LSNV Response to Draft Audit Report

Dear Mr. Merryman,

I am in receipt of your letter of July 28, 2011 and the accompanying draft report on the Selected Internal Controls Audit that was performed at Legal Services of Northern Virginia (LSNV) by LSC's Office of Inspector General (OIG) on January 24 – 31, 2011. Christopher Aballe, the on-site leader of OIG's audit team, reiterated several times during that week that the audit was intended to be a constructive exercise that would help LSNV maintain in place appropriate internal controls. We appreciated that sentiment and view this draft report in the same spirit.

We appreciate the report's general observation that "[i]nternal controls reviewed at LSNV were adequate as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability, and compliance with LSC regulations." This overall conclusion was particularly gratifying because at the time of the audit, we had been LSC-funded for a little over one year and the months after our January 1, 2010 merger with Potomac Legal Aid Society have been a period of significant transition.

We also understand the report's conclusion that certain external controls could be strengthened and formalized. I will address the specific issues as I respond to the report's various recommendations:

Recommendation 1: The Executive Director should ensure that LSNV's account manual is updated to incorporate all essential policies and processes as required by LSC's Accounting Guide.

LSNV Response: We appreciate the Draft Report's observation that LSNV already has in place policies governing such important matters as the use of credit cards, cost allocation methodology, salary advances, travel and per diem reimbursement limits, internal management reporting and budgeting, and cell phones and electronic devices. We also recognize the importance of LSNV's Board formally approving these policies as part of LSNV's Accounting Manual. The enumerated subject matters have now been added to the accounting manual (**see enclosed draft manual**) and it is our intention to present the entire document for approval at the next Board meeting (October 12th).

We would like to take this opportunity to clarify two statements from this section of the Audit Findings. First, the Draft Report observes that "[t]o satisfy LSC's requirement that each grantee must develop a written accounting manual in order to establish an adequate internal controls structure, LSNV hired a program administrator to compile policies and procedures that had been in place prior to the merger with PLAS" (p. 4). Although compiling an accounting manual was one of many tasks that have been assigned to Program Administrator, it was by no means the sole reason that this position was created. On the contrary, the Program Administrator was put in place to oversee all of our finance and human resources functions. For an organization the size of LSNV, the Program Administrator has a wide variety of time-consuming responsibilities.

The Draft Report also states that "[a]ccording to grantee management, employee turnover delayed the approval of the [accounting manual] draft until after the audit period." While employee turnover has been one factor that has impacted the current status of LSNV's draft accounting manual, it is not the sole factor. As you know, LSNV became an LSC-funded program on January 1, 2010 as a result of its merger with PLAS. The process of merging the two programs and bringing the merged program into compliance with LSC regulations has been enormously time-consuming. In addition, we wanted LSNV's new accounting manual to be consistent with the new LSC accounting guide, which was not finalized until August of 2010. Finally, we wanted to avoid having to have our Board consider the accounting manual on repeated occasions. To that end, we agreed to wait until we had the feedback of the Draft Audit Report so that we would have in writing specifically what OIG wanted to see in our accounting manual. Unfortunately, we did not get the draft report until almost 6 months after the audit visit. Now having this written feedback from OIG, we intend to submit our updated accounting manual for approval at the very next board meeting.

Recommendation: The Executive Director should ensure that

Recommendation 2: The subsidiary records of all capitalized equipment and property that were purchased or donated are updated to include the details required by the LSNV Accounting Manual and the LSC Accounting Guide.

Recommendation 3: The information contained in the PC Inventory Report is accurate and reconciled with subsidiary records; and that written policies and procedures are documented describing the processes to used to ensure that subsidiary records are accurately updated.

Recommendation 4: Inventory tags or labels are attached to fixed assets for ease of locating and accounting.

Recommendation 5: A physical inventory of all fixed assets is conducted immediately and reconciled to the property records.

LSNV Response: In principle, we share LSC's concerns with respect to the accounting for fixed assets. However, given that LSNV has been in operation for more than 30 years and has only recently renewed its status as an LSC grantee, we are concerned about the level of detail and effort required by LSC for fixed asset accounting. Any appropriate solution to this problem should take into account the time and resources that are necessary in order to effectuate that solution.

Because Potomac Legal Aid Society (PLAS) was an LSC grantee at the time of its January 1, 2010 merger with LSNV, we concur that its transferred assets should be fully accounted for and tied in to the LSNV general ledger. In fact, that has already been accomplished. LSNV, on the other hand, has an extensive fixed asset base that it has accumulated over the last 30 years, much of which was donated. A significant amount of the office furniture, fixtures, and equipment on the LSNV books was acquired well over 10 years ago, and we feel that it would be impractical, if not next-to-impossible, to add to these items any additional identifying information required by LSC. With respect to purchased items, the cost shown on LSNV's books reflects the purchase price actually paid for the assets. With respect to donated items, the cost reflects an amount deemed to be the fair market value at the time of donation. Much of our furniture, fixtures, and equipment is now virtually unusable, and some unwanted items no doubt were discarded during recent office moves. Except for our most recent acquisitions, almost all of our furniture, fixtures, and equipment has been depreciated to zero value on LSNV's books. We will be undertaking a review of our current inventory *vis à vis* our accounting records, and will remove from the books any items no longer existing within our offices. Given the extensive costs and time-consuming effort that would be required, our preference would be to avoid a retrospective review of old data. However, going forward we will endeavor to adhere to LSC's capitalization guidelines, and capture within a subsidiary ledger (tying in to the general ledger) the appropriate identifying information for any items acquired at a value of $5,000 or more -- i.e., the starting point for capitalizing set forth in LSC's accounting guide. At the same time, we will put processes in place so that LSNV's PC Inventory is updated as necessary to fully account for all computers, laptops, cell phones, and other small electronic devices.

Recommendation 6: The Executive Director should ensure that written policies and procedures are developed and implemented requiring that subgrants be monitored in accordance with LSC regulations and subgrant agreements.

LSNV Response: Although the Draft Report is correct about the monitoring requirements of older versions of LSNV's subgrant with RLS, the 2011 version of this subgrant, which was approved by LSC (**see enclosed subgrant agreement**), modified the monitoring requirements so that LSNV only had to review the quarterly case reports – which we are doing. LSNV may have provided the audit team with an outdated version of the subgrant prior to the audit. In any case, the staffs of both programs remain in regular contact with each other regarding the status and proper handling of referrals made under this subgrant.

Thank you for your consideration of this response. I am available to provide any additional information or clarifications at your convenience.

Sincerely,

James A. Ferguson
Executive Director