REPORT NO. AU 25-05

MARCH 2025

# Lone Star Legal Aid

RNO 744060

FINAL AUDIT REPORT ON

SELECTED INTERNAL CONTROLS

OFFICE OF INSPECTOR GENERAL

LSC America's Partner for Equal Justice

LEGAL SERVICES CORPORATION

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March 4, 2025

Paul Fuhrr
Executive Director
Lone Star Legal Aid
1415 Fannin Street
Houston, Texas 77002

Dear Mr. Fuhrr,

Enclosed is the Legal Services Corporation (LSC) Office of Inspector General's (OIG) final report for our audit on selected internal controls at Lone Star Legal Aid (LSLA). Appendix IV of the report includes LSLA's response to the draft in its entirety.

The OIG determined that LSLA's proposed actions address Recommendations 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, and 14. However, these recommendations will remain open until LSLA provides these items as listed on page 22.

LSLA disagreed with Recommendations 1 and their response and proposed actions do not address the findings and recommendation. Therefore, the OIG will refer this recommendation, and the questioned costs related to LSC Disaster Grants totaling $438,032 to LSC Management for further review and action.

Please send us responses to close out the 13 open recommendations, along with supporting documentation to Roxanne Caruso, Assistant Inspector General for Audit. We expect to receive your submission by September 4, 2025.

If you have any questions, please contact Roxanne Caruso, Assistant Inspector General for Audit at (202) 997-2260 or rcaruso@oig.lsc.gov. We appreciate the courtesy and cooperation extended to us during the audit.

Sincerely,

Thomas E. Yatsco

Inspector General

Enclosure

Cc: Ron Flagg, LSC President
Lynn Jennings, LSC Vice President for Grants Management
LSLA Board of Directors

# Executive Summary

## Lone Star Legal Aid (LSLA)
## Final Report on Selected Internal Controls

### Objective

The objective was to assess the adequacy of selected internal controls at LSLA and determine whether costs were supported and allowed under the Legal Services Corporation (LSC) Act of 1974, as amended, the LSC Financial Guide, as well as other applicable laws and regulations.

### Background

Headquartered in Houston, TX, LSLA is one of the largest nonprofit service providers of free legal aid in the United States. For the year ending December 31, 2022, LSLA received $43,316,033 in support, including $14,637,925 in LSC funds.

Additionally, in 2021 LSLA received

### What We Found

While LSLA had adequately implemented controls over certain areas, such as employee benefits and general ledger and financial controls, we identified critical issues in disaster grant management and significant policy deficiencies across various operational areas, resulting in 15 reportable findings.

Key findings include:

- LSC Disaster Grants – We identified questioned costs of $438,032 due to improper documentation and non-compliance with disaster grant requirements.
- Policy Deficiencies – We found inadequate policies for credit card usage, outdated cost allocation policies, no policy governing re-bidding of long-standing contracts, unclear policies for Board member travel reimbursements, and incomplete budgeting and management reporting procedures. Additionally, there were discrepancies between written policies and actual practices, which increased the risks of non-compliance and operational efficiencies.

These findings were primarily due to outdated policies, inconsistencies in adhering to their own policies, and insufficient management oversight.

### What We Recommend

This report includes 14 recommendations, primarily focused on adequate documentation. Some recommendations call for updating and implementing more comprehensive policies and procedures, addressing broader operational needs, and going beyond basic documentation requirements. Additionally, we determined that policies should be updated to align with the LSC Financial Guide.

$866,761 in LSC Disaster Grant funding.

## Management Response

LSLA management agreed with six recommendations, partially agreed with five recommendations, and disagreed with three recommendations.

LSLA provided proposed actions that address Recommendations 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, and 14. However, these thirteen recommendations will remain open until the OIG is provided with evidence of the strengthened policies and procedures.

LSLA disagreed with Recommendations 1, 2, and 8, although their response and proposed actions for Recommendations 2 and 8 address OIG's findings. LSLA's response and proposed actions for Recommendation 1 do not address OIG findings. The OIG will refer this recommendation, and the questioned costs related to LSC Disaster Grants, totaling $438,032, to LSC Management for further review and action.

# Table of Contents

# Introduction

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls at the LSC grantee, Lone Star Legal Aid (LSLA), for operations and oversight.

Section 2.5.2 of LSC's Financial Guide[1] requires LSC recipients, such as LSLA, under the direction of their Board of Directors, to establish adequate accounting records and internal control procedures. It defines internal controls as the processes put in place, maintained, and overseen by the recipient's Board of Directors and management to provide reasonable assurance that the organization:

- safeguards assets against unauthorized use or disposition;
- produces reliable financial information and reporting; and
- complies with regulations and laws that have direct and material effect on its programs.

Our objective was to assess the adequacy of select internal controls at LSLA and determine whether costs were supported and allowed under the LSC Act of 1974, the LSC Financial Guide, as well as other applicable laws and regulations.

To accomplish the audit objective, we evaluated select internal controls in the following twelve financial and operational areas: LSC Disaster Grants, credit cards, cost allocation, contracting, disbursements, budgeting and management reporting, payroll, derivative income, general ledger and financial controls, client trust funds, property and equipment, and employee benefits.

The audit period under review was January 1, 2022, through December 31, 2023.

# Background

LSLA is one of the largest nonprofit service providers of free legal aid in the United States. LSLA has 14 offices that service nearly 60,000 square miles in Texas and Arkansas. LSLA's service area includes over two million individuals eligible for free legal services. According to LSLA, they help clients with issues such as tax relief, fair housing, family law, domestic violence, and veterans' benefits.

According to the audited financial statements for the year ending December 31, 2022, LSLA received $43,316,033 in support. LSC funds made up $14,637,925, or 34 percent of the funds. Other sources, including other federal funds and state funds, made up $28,678,103, or 66 percent.

[1] Effective January 1, 2023, the Accounting Guide for LSC Recipients (2010 Edition) was superseded by the LSC Financial Guide. Because the audit period was January 1, 2022, through December 31, 2023, we used both guides as criteria for our findings. However, we ensured that all recommendations made in the report are consistent with the current LSC Financial Guide.

# Audit Results

We determined that LSLA's internal controls for operations and oversight of property and equipment, derivative income, employee benefits, and general ledger and financial controls were adequately designed and properly implemented. However, in other areas reviewed, we found that LSLA needs to strengthen its practices or formalize, in writing, internal controls—as described in figure 1.

Figure 1 - Summary of Findings

| Audit Section | Findings Summary |
|---|---|
| LSC Disaster Grants | • Leave & holiday hours may not have been proportionately allocated based on hours worked - Legal Aid Disaster Resource Center Grant (LADRC) Grant<br>• Charged expenses to the incurred costs grant that were not related to the designated disasters<br>• Leave hours may not have been proportionately allocated based on hours worked – Incurred Costs Grant<br>• Lacked information to support the grant request for the office closures and submitted inaccurate salary information |
| Contracting | • No policy to recompete long-standing contracts<br>• Inadequate documentation of competitive bidding and sole-source justifications<br>• Some contracts signed by unauthorized personnel |
| Cost Allocation | • Inadequate written cost allocation policies<br>• Allocations were not consistently proportionate among funding sources |
| Credit Cards | • Inadequate written credit card policies |
| Disbursements | • Absence of clear policies for Board member travel reimbursement |
| Budgeting and Management Reporting | • Incomplete written budgeting and management reporting policies<br>• Inadequate documentation of management's monthly financial report review |
| Payroll | • Inadequate payroll policies for reconciling labor costs and equitably allocating paid time off |
| Client Trust Funds | • Discrepancies between policies and practices |

# LSC Disaster Grants

LSLA received two different disaster grants from LSC. A Legal Aid Disaster Resource Center (LADRC) Grant, amounting to $195,043, was provided to LSLA in 2021 for covered personnel expenses, including salaries and fringe benefits, specifically for activities related to the administration of the LADRC website. In contrast, a Disaster Supplemental Appropriation (Incurred Costs Grant[2]), totaling $866,761 was administered to LSLA to cover broader disaster-related costs, including personnel, fringe benefits, project expenses, and indirect costs[3] related to Hurricane Laura in 2020 and Winter Storm Uri in 2021. The primary difference between these grants is the scope of allowable expenses: the LADRC Grant focused on direct[4] personnel costs for the administration of the LADRC website and to support disaster recovery efforts, while the Incurred Costs Grant included a wider range of costs related to disaster impact and recovery efforts. See figure 2.

Figure 2 – LSLA's Use of LSC Disaster Grants

| | | LADRC Disaster Grant<br>2019 Disaster Supplemental Appropriation | Incurred Costs Grant<br>2020-2021 Disaster Supplemental Appropriation |
|---|---|---|---|
| **Personnel Expenses** | *Salary* | $141,000 | $579,136 |
| | *Fringe Benefits* | $54,043 or approximately 38% | $195,146 or approximately 34% |
| **Project Expenses** | | N/A | $5,591 |
| **Indirect Costs** | | N/A | 10% de minimis or $86,887 |
| **Total** | | $195,043 | $866,761 |

We reviewed transactions pertaining to these disaster grants. For the LADRC Grant, we focused on personnel expenses, selecting months with the highest costs for detailed examination. Our review found that LSLA charged $141,000 in salaries to the grant but incorrectly classified leave and holiday hours as direct costs. Leave and holiday hours are an employee benefit earned over time and the cost of these benefits cannot be readily identified with a particular final cost objective, especially if an employee works on various grant projects throughout the year. For the Incurred Costs Grant, we

[2] Incurred Costs Grants are available to reimburse LSC grantees for costs already incurred serving survivors of eligible disasters.

[3] Indirect costs are expenses incurred by an organization that cannot be directly attributed to a specific project or activity, such as overhead costs, administrative salaries, and office supplies, which support the organization's operations as a whole. Holiday and leave time are generally considered as indirect costs.

[4] Direct costs are expenses that can be directly attributed to a specific grant, project, or activity.

analyzed a broader range of expenses and found issues with leave hours that were improperly charged, leading us to review the entire $579,136 in salaries.

LSLA maintained timekeeping records but misclassified leave and holiday hours as direct costs for the LADRC Grant and leave for the Incurred Cost Disaster grant. They also submitted an inaccurate budget application and lacked adequate support and information for the Incurred Costs Grant, which included unallowable expenses unrelated to the disasters. These errors resulted in questioned costs totaling $438,032. Figure 3 below lists the breakdown of these questioned costs.

Figure 3 – Breakdown of Disaster Grant Questioned Costs

| LSC Disaster Grant Type | Reason for Questioned Costs | Amount |
|---|---|---|
| LADRC | Unable to determine if leave and holiday hours were proportionately charged | $39,983 |
| **Total LADRC** | | **$39,983** |
| Incurred Costs Grant | Unallowable expenses | $287,624 |
| | Unable to determine if leave hours were proportionately charged | $110,425 |
| **Total Incurred Costs Grant** | | **$398,049** |
| **Total Questioned Costs** | | **$438,032** |

### *LSLA May Not Have Proportionately Allocated Leave and Holiday Hours Charged to the LADRC Disaster Grant*

LSLA tracked and maintained an accurate record within their case management system of time spent on various activities, such as case work, outreach, general tasks, as well as leave and holiday hours. Also, the allocations of staff time (attorneys and paralegals) and fringe benefits align with LSC's approved budget for the LADRC disaster grant.

However, we found that LSLA's practices for coding leave and holiday hours were inadequate to identify if these hours were proportionately allocated to the grant. Specifically, each LSLA employee directly codes and charges leave and holiday hours to grant funding sources according to their assignment(s) within the pay period that the leave is taken. As a result, the leave time taken may not be distributed to all activities in proportion to the relative total amount of time and effort devoted by the employees to each grant activity. Per LSLA management, there may be instances where a manager reassigns an employee to a new grant assignment and then takes leave; therefore, the leave expenses accrued while working on a previous grant may be charged to the new grant assignment. Because leave and holiday hours totaling 1,222 hours, equivalent to $39,983, were directly charged to the

LADRC disaster grant, we were unable to determine whether these hours were proportionately allocated to the LADRC grant based on hours worked or the relative amount of time devoted to the grant.

LSLA management justified their practices, stating that employee leave and holiday expenses are considered direct costs of the grant because the accrued time off is earned by the individual as part of their compensation package, directly contributing to the program's expenses. In addition, LSLA management stated that LSC allowed LSLA to charge health insurance which, they contended, is not different from charging leave and holiday pay. However, LSLA's practices for coding leave and holiday hours do not align with the following LSC regulations and guidance:

- LSC regulation 45 C.F.R. § 1630.5(e), which defines indirect costs as "those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective." We noted that leave and holiday hours are generally considered indirect costs because they are not attributable to a specific grant, project, or activity.

- LSC regulation 45 C.F.R. § 1635.4(a), which states that recipients must allocate salaries and wages based on records that accurately reflect the work performed.

- The LSC Financial Guide, Section 2.2.3, which requires labor cost distribution reports to be reconciled against individual timekeeping reports. The guide provides an example of an attorney's salary that is funded by multiple sources and indicates that holiday and leave pay should be proportionally allocated to each funding source based on hours worked.

Charging staff leave time and holiday hours that do not directly support the activities of the LADRC grant could reduce the available funding for essential program activities and resources to help those impacted by the disasters, thereby limiting the grant's intended purpose, impact, and scope.

We identified questioned costs concerning employee leave and holiday expenses equivalent to 1,222 hours, equivalent to $39,983 that were directly charged to the LADRC Disaster Grant. Additionally, we were not able to determine if these hours were proportionately allocated to the grant based on hours worked. We are referring this amount to LSC Management for review and action pursuant to 45 C.F.R § 1635.4(a), 45 C.F.R § 1630.5(e), and the LSC Financial Guide, 2.2.3.

### *LSLA Charged Expenses to the Incurred Costs Grant That Were Not Related to the Designated Disasters*

LSLA charged $287,624 of expenses to the Incurred Costs Grant that were unrelated to Hurricane Laura in 2020 and Winter Storm Uri in 2021. This was contrary to the terms specified in LSC's grant's Notice of Fund Availability (NOFA) guidelines. In addition, these expenses did not fall within the calendar years 2020 and 2021, when the disasters occurred. Our review of the supporting documentation for fringe benefits, project expenses, and indirect costs revealed the following:

- **Fringe Benefits:** From April through September 2022, LSLA charged $195,146 in retirement benefits that were unrelated to the disasters.
- **Project Expenses:** LSLA charged $5,591 for elevator and Heating, Ventilation, Air Conditioning (HVAC) preventive maintenance and repairs unrelated to the disasters, with invoices dated from April 2022 through June 2022.
- **Indirect Costs:** From April 2022 through September 2022, LSLA charged $86,887 for rent, telephone, insurance, and internet expenses that did not directly pertain to the disasters.

The support provided to us for the expenses listed above were unrelated to the disasters from 2020 and 2021; rather, the expenses were from LSC Basic Field Grant expenses in 2022. For instance, LSLA removed expenses from LSC's Basic Field Grant in 2022 to offset the Incurred Costs Grant without confirming their relevance to the disasters.

The expenses charged to the Incurred Costs Grant were not disaster-related and therefore do not comply with the following regulations and guidelines:

LSC regulation 45 C.F.R. § 1630.5(a) subsections (1), (2), (4), and (8) state that expenditures are only allowable under an LSC grant if the recipient can prove the costs were incurred while performing the grant, were reasonable and necessary for the grant, in compliance with the terms and conditions of the grant or contract, and properly documented in accessible business records.

The Incurred Costs Grant NOFA, Section C, specifies that grant funds can only be used for activities and expenses related to hurricanes, wildfires, extreme weather, and earthquakes from 2020 and 2021. Additionally, the NOFA instructs grantees to provide documentation for all expenses incurred.

Failure to comply with LSC regulations and guidelines could lead to disallowance of costs. In addition, compliance with LSC regulations and guidelines and careful fiscal management helps ensure fulfillment of the grant terms and objectives.

We identified questioned costs related to the unallowable expenses totaling $287,624. We are referring this amount to LSC Management for review and action pursuant to 45 C.F.R. § 1630.5(a) subsections (1), (2), (4), and (8) and Incurred Cost Grant NOFA, Section C.

### *LSLA May Not Have Proportionately Allocated Leave Hours Charged to the Incurred Costs Grant*

LSLA's practices for coding leave hours were inadequate to identify if these hours were proportionately allocated to the Incurred Costs Grant. For instance, LSLA directly charged leave hours to a funding code—and the code used indicated that these hours were charged to both LSC and a state funding source. Therefore, we were unable to determine if the leave hours totaling 2,455, equivalent to $110,425, charged to the Incurred Costs Grant were proportionately allocated to that grant based on hours worked.

LSLA directly charged leave hours to the Incurred Costs grant, based on their interpretation that these hours qualified as direct costs. Per LSLA management, leave hours are considered direct costs because they were charged to the grant due to disaster related office closures. They explained that employee leave time is a benefit of employment, that, like health insurance and retirement plan contributions, has an associated dollar value. They stated that fringe benefits such as leave time are necessary costs of employing staff for the grant and are therefore considered direct costs. They emphasized that leave time is specifically linked to the grant funding source and does not fall under the definition of an indirect cost since it is not a common or joint objective, but rather a specific objective of the grant.

LSLA's practices for coding leave hours do not align with the following regulations and guidelines:

- LSC regulation 45 C.F.R. § 1635.4(a) states that recipients must base allocations of salaries and wages on records that accurately reflect the work performed. In addition, 45 C.F.R. § 1630.5(e), defines indirect costs as, "those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective."
- Uniform Guidance Section 200.431 (b)(2) states that leave is the cost of fringe benefits in the form of regular compensation paid to employees during authorized absences, such as annual leave, sick leave, holidays, and similar benefits, are allowable if the costs are fairly distributed among all related activities, including Federal awards.
- The LSC Financial Guide, Section 2.2.3, requires that labor cost distribution reports be reconciled against individual timekeeping reports. The guide provides an example of an attorney's salary that is funded by multiple sources and indicates that holiday and leave pay should be proportionally allocated to each funding source based on hours worked.

  Charging staff leave hours directly to the Incurred Costs Grant without reconciling against labor cost distribution reports may result in improper allocations of payroll costs to the grant.

  We identified questioned costs related to administrative leave hours totaling $110,425 charged to the Incurred Costs Grant due to office closures. We are referring this amount to LSC Management for review and action pursuant to 45 C.F.R § 1630.5(a) subsection (1), (2), (4), and (8), 45 C.F.R § 1630.5(e), and the LSC Financial Guide section 2.2.3.

### *LSLA Lacked Support for the Incurred Costs Grant Request for Office Closures and Submitted Inaccurate Salary Information*

LSLA's application for the Incurred Costs Grant included a budgeted line item of $579,136 for salaries that included administrative leave due to office closures. However, we found that it lacked specific details about the number of offices impacted and the number of staff on administrative leave due to the disasters.

Furthermore, our review of timekeeping records indicated that LSLA did not clearly distinguish between hours worked on a case[5], matter[6], or supporting activity[7] and administrative leave[8] in the budget request submitted to LSC. The actual hours worked on cases or supporting activities totaled 12,796 hours, equivalent to $468,711, which is materially higher than the $356,541 requested by LSLA. Conversely, the actual leave time or office closure time was 2,455 hours, equivalent to $110,425, which is lower than the $222,595 claimed.

The insufficient information and errors in the grant application for the salaries in the Incurred Costs Grant were attributed to management oversight. LSLA management acknowledged the mistakes, noting that there were minimal leave hours included in the request for case time hours. Additionally, some case time hours were mistakenly included in the hours requested for administrative leave due to office closures.

LSLA submitted an inaccurate grant application for the total hours worked and administrative leave for the Incurred Costs Grant. Therefore, LSLA was not in compliance with the LSC regulation 45 C.F.R. § 1630.5(a) subsections (1), (2), and (8), which state that expenditures are only allowable under an LSC grant if the recipient can prove the costs were incurred while performing the grant, were reasonable and necessary for the grant, and properly documented in accessible business records.

An application for LSC disaster grants that lacks sufficient and accurate information may misinform LSC Management, potentially leading to the approval of unallowable activities and expenses per 45 C.F.R. § 1630.5(a) subsections (1), (2), and (8).

**Recommendation 1:** We recommend the CEO perform a review of the Incurred Costs Grant budget application and timekeeping records related to the disasters from 2020 and 2021 to identify the actual hours worked and corresponding costs for case time and administrative leave hours for office closures. The review should clearly distinguish between distinct categories of hours, including actual case/matter/supporting activity hours and leave.

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[5] A case is defined in 45 C.F.R. § 1635.2 as a form of program service in which a recipient employee provides legal assistance to one or more specific clients.[6] A "matter" is defined in 45 C.F.R. §1635.2 as an action which support the overall delivery of program services but does not involve direct legal advice or legal representation for specific clients.[7] Supporting activity is defined in 45 C.F.R. § 1635.2 as any action that is not a case or matter.

[6] A "matter" is defined in 45 C.F.R. §1635.2 as an action which support the overall delivery of program services but does not involve direct legal advice or legal representation for specific clients.[7] Supporting activity is defined in 45 C.F.R. § 1635.2 as any action that is not a case or matter.

[7] Supporting activity is defined in 45 C.F.R. § 1635.2 as any action that is not a case or matter.

[8] Leave is defined in 2 C.F.R. § 200.431(b)(2) as the cost associated with employee compensation for authorized absences, such as sick, holiday, court, military, administrative, and similar benefits. These costs are allowable if they are equitably allocated across all related activities, including Federal awards. We referred to the Uniform Guidance 2 C.F.R. § 200.431 because it sets the standards for managing federal awards, including LSC grants.

**Recommendation 2:** We recommend the CEO implement a procedure to ensure that all relevant information, including the dates of office closures, offices impacted or closed, and staff on administrative leave due to disasters Hurricane Laura and Winter Storm Uri are adequately documented; and do so each time such actions are taken in response to future disasters.

# Contracting

We found that LSLA had contracting policies that identified dollar thresholds, the associated competition and approval requirements, and included procedures for sole-source procurements. In practice, the contracts we sampled were maintained, completed, and signed, with payments made according to contract terms. However, LSLA did not follow other requirements contained in their policies. For example, we found bids that were missing documentation and contracts that lacked sole-source justification, and some contracts that were signed by individuals not authorized under LSLA's procurement policy. Additionally, LSLA did not have a formal policy to recompete long-standing contracts.

### *LSLA Did Not Have a Policy to Recompete Long-Standing Contracts*

LSLA did not have a formal policy to recompete long-standing contracts. Management stated that, in practice, many contracts are re-evaluated after their initial term, but this is not formally documented.

LSLA's inadequate policy over long-standing contracts stems from management oversight. LSLA management acknowledged that they have not updated their policies and procedures to include the evaluation of long-standing contracts.

The lack of such policy conflicts with LSC Program Letter 16-3, Procurement Policy Drafting 101, which advises that recurring purchases and long-standing contracts should be recompeted every 3-5 years to ensure the best value.

By not periodically recompeting long-standing contracts, LSLA may not be receiving the best value for their money.

**Recommendation 3:** We recommend that the CEO revise LSLA's contracting policy to require recompeting recurring purchases and long-standing contracts every three to five years.

### *Four Contracts Were Missing Documentation of Competition or Sole-Source Justification*

Four contracts in our sample lacked bids or sole-source[9] justification and approval. One contract was sole-sourced; and the procurement methods for the other three were unclear. Under these four contracts, LSLA paid vendors $47,089 during our audit period.

We found that adequate documentation was not maintained due to management oversight. LSLA management told us that various circumstances led to the discrepancies and, in their view, their actions were justified; however, none of these contracts had contemporaneous documentation of these justifications.

[9] A sole-sourced contract is an agreement awarded to a single supplier or vendor without a competitive bidding process, typically because the supplier is uniquely qualified or because there is an urgent need that only the vendor can fulfill.

In taking these contracting actions, LSLA did not adhere to their own Procurement and Purchasing policy, specifically the following requirements:

- **For Medium Purchases ($25,000 to $150,000)**, at least two documented rate quotes or comparisons, unless sole-sourced.
- **For Sole-Sourced Medium and Greater Purchases**, the purchase must be pre-approved by the CEO with the reason specified.

Additionally, LSLA's practices did not adhere to the LSC's Financial Guide, Section 3.5.1, which emphasizes the importance of competition, negotiating terms, documentation, and internal controls for effective procurement.

Without sufficient competition, LSLA may not receive the best value for its money. If sole-source procurements are not properly documented and approved, goods or services could be obtained at unreasonable prices or without thorough review.

**Recommendation 4:** We recommend that the CEO implement a process to ensure LSLA follows its procurement policy. This includes documenting bids for all applicable purchases. Additionally, sole-source justifications should be documented and approved.

### *Four Contracts Were Signed by Unauthorized Personnel*

Four out of seven contracts tested were signed by personnel other than the CEO, which is contrary to LSLA's procurement policy.

Management explained that the CEO sometimes delegates contract signing to others, such as the CFO, through electronic signing methods. They plan to update their policies to set parameters over when the CFO and Deputy Director can sign contracts.

In contrast, LSLA's Procurement and Purchasing Policy states that the CEO is the only employee authorized to enter into contracts on behalf of LSLA.

If authorized personnel do not sign contracts, LSLA may enter into contracts at unreasonable prices or under unsatisfactory terms.

**Recommendation 5:** We recommend that the CEO implement a process to ensure unauthorized personnel do not enter into contracts on behalf of LSLA. Alternatively, if LSLA decides that it would be beneficial to allow more flexibility in contract approval authority, this should be formalized in the written policies and any deviations from the written policies should be adequately documented and approved.

# Cost Allocation

We found that LSLA cost allocations[10] were performed timely. However, LSLA did not follow detailed written policies for allocating costs, did not allocate unrestricted funds for indirect costs, and did not allocate the full amount of indirect costs allowed by one private funding source.

### *LSLA's Written Cost Allocation Policies Were Outdated and Lacked Detail*

While LSLA had written cost allocation policies, they were out of date and lacked specific details as called for in LSC guidance, such as comprehensive methodologies for allocating costs and documentation requirements that would allow for third party review. When performing cost allocations, LSLA made subjective adjustments that were not included in their policies, such as decreasing the amount allocated to a grant near the end of its term to preserve funds to carry into the next term.

LSLA did not perceive their cost allocation processes as non-compliant. LSLA management acknowledged that the policies needed revision to reflect the process they currently follow but believed that the current process was compliant.

LSLA's cost allocation policies were not compliant with LSC's Financial Guide, Section 3.7.1, which states that recipients must maintain accounting systems that demonstrate the proper allocation of costs to each funding source. The cost allocation policy must include:

- Definitions of direct and indirect costs;
- Methodologies for allocating direct and indirect costs;
- Allocation bases (e.g., total direct costs, direct salaries, attorney hours, etc.);
- Frequency of allocations;
- Responsibilities for conducting and reviewing allocations;
- Documentation required to support allocations (e.g., labor distribution report, personnel activity reports, calculation work papers);
- Reconciliation processes for salaries and wages directly charged to LSC grants; and
- Methodology to address "exception for certain indirect costs."

Overall, the recipient's cost allocation policy, procedures, and documentation must allow for third party review.

Without a written cost allocation policy that allows for third party review, LSLA may be unable to demonstrate that its allocations were reasonable and equitable.

[10] Cost allocation is the process used to equitably distribute costs among the organization's various funding sources.

**Recommendation 6:** We recommend that the CEO ensure LSLA's written cost allocation policies are updated to fully align with LSC requirements. Subjective adjustments should be minimized, and the considerations resulting in those adjustments should be formalized in the policies.

### *LSLA's Allocations Were Not Consistently Proportionate Among Funding Sources*

LSLA did not follow LSC guidance over allocating indirect costs to unrestricted funds.[11] In addition, we found that a private funder allowed for a 19 percent indirect cost rate. However, LSLA chose to only use the ten percent de minimis[12] rate and allocated the remaining nine percent to the salary of an employee working for the grant. As a result, LSC and other funders were charged the additional nine percent.

The unrestricted funds were not allocated due to management oversight. LSLA management explained that this was because the unrestricted funds were inadvertently missed due to the immateriality of the unrestricted funds. LSLA's strict adherence to its 10 percent de minimis indirect cost rate policy, despite being allowed a higher cost rate, led to a disproportionate share of indirect costs among the other funding sources. Per LSLA management, they remained consistent with their own policy of using 10 percent de minimis rate and used the remining amount to achieve grant support initiatives.

LSLA's procedures for allocating indirect costs to unrestricted funds did not adhere to LSC Program Letter[13] 18-2, which states, "Unrestricted funds must be included as a source of funds available to pay for indirect costs."

The disproportionate allocation is not incompliance with the C.F.R. 45 § 1630.5(g):

> Some funding sources may refuse to allow the allocation of certain indirect costs to an award. In such instances, a recipient may allocate a proportional share of another funding source's share of an indirect cost to LSC funds, provided that the activity associated with the indirect cost is permissible under the LSC Act, LSC appropriations statutes, and regulations.

In Program Letter 18-2, LSC states, "another funding source must refuse to pay all or some of its share of indirect costs before a recipient may charge any portion of those costs to its Basic Field Grant."

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[11] Unrestricted funds are financial resources that an organization can use at its discretion, without limitations or conditions imposed by donors or external entities, with certain exceptions.

[12] Uniform Guidance Section 200.414(f) allows for a **de minimis indirect cost rate** of 10 percent of modified total direct costs for organizations that does not have a current negotiated indirect cost rate. This rate can be used to cover indirect costs without the need for detailed documentation and negotiation, simplifying the process for small or less complex organizations.

[13] A Program Letter describes the most common compliance issues that LSC's Office of Compliance and Enforcement (OCE) has observed during compliance oversight visits in the past twelve months, or which have otherwise come to LSC Management's attention.

If unrestricted funds are not used for indirect costs, the burden on other funding sources will be increased, which could result in disproportionate share of indirect costs. By not allocating the maximum allowable indirect costs to a funding source, grantees place a disproportionate burden on other funders, such as LSC, which could result in questioned costs.

**Recommendation 7:** We recommend that the CEO update LSLA's cost allocation methodology to ensure unrestricted funds are equitably included as a source to pay for indirect costs.

**Recommendation 8:** We recommend that the CEO ensure LSLA allocates the maximum allowable indirect costs to all funding sources, as per LSC guidance.

# Credit Cards

Our review found that all 30 sampled credit card transactions were supported by a receipt, and we were able to adequately trace all transactions to the general ledger. However, LSLA did not have adequate policies for credit card usage.

### *LSLA Had Inadequate Credit Card Policies*

We found no written policies and procedures related to credit card usage, statement reviews, reconciliations, or payment processes in LSLA's Accounting Manual. While LSLA had credit card authorization forms, the reconciliation and review process were not documented and there were no policies on credit card transactions or spending limits.

The inadequate credit card policies attributed to LSLA's decision to delay updating known outdated policies. LSLA management acknowledged the need to create and document strong policies and procedures regarding credit card usage. They indicated they were waiting for the results of this audit before making changes.

LSLA's lack of policies and procedure as it relates to credit card usage does not adhere to The LSC Financial Guide, Section 2.5.2a, which requires clear policies for financial transactions, documenting authority, and criteria for modifying procedures. This section of the LSC Financial Guide also states that the policies should define the roles and responsibilities of accounting and finance personnel and that grantees should develop an appropriate process to justify deviations from written policies and procedures.

Implicit, unwritten delegations of authority and undocumented practices can lead to misunderstandings and inefficiencies. Without spending limits, there is an increased risk of unrecoverable funds in the event of theft or fraud. Card limitations are a fraud prevention practice that ensures if a card is stolen, only a certain amount can be charged each day until the theft is reported.

**Recommendation 9:** We recommend the CEO update the LSLA Accounting Manual to include policies and procedures surrounding card usage, statement reviews, payment processes and the credit card reconciliation process.

# Disbursements

We found that LSLA generally followed its established disbursement[14] policies and LSC requirements. While all transactions were properly recorded in the general ledger, we noted the absence of Board Travel Reimbursement policies.

### *LSLA Lacked Clear Board Travel Reimbursement Policies*

We reviewed LSLA's Board meeting transactions totaling $17,943 and policies related to Board travel reimbursements, including lodging, meals, and incidentals. As a result, we found an absence of explicit written policies over travel reimbursements and per diem limits. The lack of policies also attributed to expenses paid for an individual who is neither a Board member nor an employee, along with undocumented per diem limit overrides, and an LSC-funded unallowable charge.

LSLA's inadequate policy and flexibility, while intended to address reasonable needs of Board members, led to an approval of LSC unallowable charges. LSLA management stated that they have the authority to override per diem allowances under reasonable circumstances, such as when board members travel long distances, and either arrive early or stay beyond the scheduled event.

When we brought the unallowable charge to LSLA management's attention, they promptly admitted the error and reallocated the expense from LSC funds to their unrestricted funds.

LSLA's lack of clear board travel reimbursement policies does not adhere to the LSC Financial Guide, Section 3.2.4b, which states that grantees must have written travel policies detailing the approval processes, reimbursement procedures, spending limits, per diem allowance definitions, and required supporting documentation. These policies should also specify thresholds for retaining receipts and timelines for submitting travel expense reports.

Implicit unwritten policies and procedures related to Board travel reimbursements can lead to inconsistent practices and increased risk of LSLA incurring expenses that are not allowable under LSC rules. It may also lead to misunderstandings and inefficiencies among staff and Board members. Additionally, inadequate supporting documentation may result in transactions made without management's knowledge.

**Recommendation 10:** We recommend the CEO establish explicit written policies and procedures for board travel reimbursement policies. In addition, the policies should stipulate when per diem allowance limits can be overridden as well as the required documentation of review and approval.

[14] Disbursements are payments by check, cash, or electronic fund transfers to vendors.

# Budgeting and Management Reporting

We reviewed LSLA's budgeting and management reporting processes. We found that the monthly financial reports were prepared and reviewed by management, and the budgeting process involved top management. However, we found that LSLA's policies and practices did not fully align with LSC's budgeting and management reporting guidance. Also, management did not document their review of the monthly reports.

### *LSLA's Written Budgeting and Management Reporting Policies Were Incomplete*

LSLA's Accounting Manual did not address several of LSC's criteria regarding budgeting and management reporting. Specifically, LSLA's policies did not specify:

- the timeline for preparing management reports; we learned in interviews that they are prepared by the 15th of each month.
- that the monthly reports identify known commitments[15] that would have a material effect on the amounts reflected in the reports.
- that budgets are built from cost centers and rolled up into the final budget.
- that budgets are formatted to coincide with the format of management reports.
- the contents of the income and expense report.
- that projections are supported by schedules that document assumptions used to arrive at final projected amounts.
- that a budget to actual report is prepared; the policies state that an income and expense report is prepared monthly, but it is not clear whether this fulfills the purpose of a budget to actual report.

The incomplete policies over budgeting and management reporting were attributed to LSLA's decision to delay updating their outdated policies. LSLA management acknowledged that their policies needed revision but decided to wait for the results of our review before updating their Accounting Manual.

LSLA's policies and practices were not compliant with LSC's Financial Guide, Section 2.6, which states that recipients should have policies documenting the exact types of reports necessary for their operations and internal management reporting process. LSC requires the following reports:

1. Total Program Budget vs. Actual
2. Funding Source Budget vs. Actual
3. Monthly Statement of Cash on Hand

[15] **Commitments** are known future obligations or expenses an organization has agreed to but have not yet recorded. Including them in reports ensures all significant upcoming costs are considered.

LSC also recommends considering known commitments that materially affect financial reporting, preparing a Cost Center Budget vs. Actual report and including projections in reports to compare with actual expenses.

Incomplete budgeting and reporting policies increase the risk of inconsistent financial oversight, potentially leading to mismanagement, poor decision making, or non-compliance with LSC requirements.

**Recommendation 11:** We recommend that the CEO revise LSLA's written policies to include the following details:

- Timeline for preparing management reports
- Identification of known commitments
- Contents of the income and expense report
- Support of projections by schedules that document assumptions used to arrive at final projected amounts
- Budget constructions from cost centers
- Format of management reports
- Preparation of a budget to actual report or similar report containing the required information

### *Management Did Not Document Their Reviews of Monthly Financial Reports*

We found that management did not formally document their review of monthly financial reports.

LSLA management indicated that previously the review of monthly financial reports occurred either in person or through email, without officially recording the reviewer's signature and date. To address this, LSLA plans to enhance its procedures and policies, ensuring that all reviews are formally documented. LSLA's practice was not in line with the requirements of LSC's Financial Guide, which states in Section 2.6, "Recipients must prepare monthly management reports timely with management and Board review."

Failure to formally document the review of monthly reports increases the risk of insufficient oversight, potentially leading to undetected errors and non-compliance with LSC requirements.

**Recommendation 12:** We recommend that the CEO implement a process to document management's review of monthly reports. This should include a signature and date to denote the review and ensure compliance with LSC's Financial Guide.

# Payroll

Overall, LSLA's internal controls over payroll were compliant with LSC guidelines. However, LSLA lacked clear procedures for reconciling labor costs with individual timekeeping records and ensuring that paid time off is proportionally charged to their funding sources based on hours worked.

### *LSLA Lacked Clear Policies for Reconciling Labor Costs and Equitably Allocating Paid Time Off Across Funding Sources*

LSLA's payroll policies did not clearly explain how labor costs are reconciled with the time employees actually worked, based on their timekeeping records.

Currently, LSLA's accounting team and grant managers review how much time employees spent working under different funding sources. They also track hours spent on various activities including training, intake, litigation, and leave. However, there is no clear method to indicate if paid time off is charged equally to the different funding sources, based on the employees' hours worked.

LSLA management acknowledged that paid time off may not always be charged proportionately to their grants, especially for grants that do not cover certain benefits, or when employees switch to new projects funded by different grants. However, because of a lack of clear policies, we could not verify if the reconciliations of paid time off were accurately performed.

These conflicts with the LSC Financial Guide 2.2.3, which states that payroll costs, including time off, must be compared with the hours employees actually worked to ensure the appropriate use of funds. This comparison check should be done at least yearly, and there should be clear policies and procedures on how it is performed.

Without these policies and procedures, LSLA risks not complying with LSC guidance and could potentially end up inappropriately assigning payroll costs to their various fund sources.

**Recommendation 13:** We recommend the CEO update the LSLA Accounting Manual to include policies for reconciling labor costs with timekeeping records, and to ensure that paid time off is allocated proportionally based on hours worked across different funding sources.

# Client Trust Funds

We reviewed LSLA's policies and procedures for managing client trust funds[16] and found that they generally followed LSC requirements and guidance. All client trust bank accounts were reconciled and LSLA maintained supporting documentation for all tested transactions. However, we noted instances where LSLA did not follow their policies and procedures over management of client trust funds.

### *LSLA Did Not Follow Their Written Client Trust Fund Policies*

We noted the following discrepancies between LSLA's written policies and their actual practices:

- According to LSLA's Accounting Manual, the Director of Finance is responsible for preparing bank reconciliations (including client trust accounts), which are then reviewed by the CFO. In practice, LSLA did not follow this policy, as a staff member not involved with cash receipts prepares the bank reconciliations and the Director of Finance reviews them.
- LSLA's Accounting Manual states that "state escheat laws govern the disposition of unclaimed client funds." However, in contrast, management indicated that their legal counsel had determined that state escheat[17] laws did not apply to client funds.

The discrepancies between practices and policies over client trust funds were attributed to LSLA's decision to delay updating known outdated policies. LSLA management was aware that their written policies needed revision, but they decided to wait for the results of our review before revising the accounting manual and related policies.

LSLA's current processes are not in compliance with the LSC's Financial Guide, Section 2.5.2.a, which states, "All recipients are required to maintain a current Accounting Policy and Procedures Manual." In addition, LSC's Financial Guide, Section 3.2.6 provides guidance for handling client trust funds, including reconciliation procedures. It also states that recipients must establish procedures (as part of their client trust fund policy) for the disposition of unclaimed client trust funds. The guide states that each LSC recipient must adopt written policies and procedures to guide its staff in compliance with this section.

Without current and detailed written policies, staff may be uncertain about the proper procedures for handling client funds, leading to potential mismanagement and non-compliance with requirements.

**Recommendation 14:** We recommend that the CEO ensure LSLA's written policies reflect the actual practices in place and comply with the applicable legal requirements for unclaimed client funds.

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[16] Client trust funds are accounts where LSLA holds and manages money on behalf of their clients, ensuring it is kept separate from the organization's funds and is used only for the client's intended purposes.
[17] **Escheat** is the legal process by which unclaimed or abandoned money or assets reverts to the state when the rightful owner cannot be located or has died without legal heirs. This process ensures that LSLA's client trust funds are handled properly.

# OIG Evaluation of Grantee Management Comments

On January 15, 2025, LSLA responded to the OIG's Draft report, agreeing to six recommendations, partially agreeing with five, and disagreeing with three. For Recommendations 3, 7, 9, 10, 11, and 12, with which they agreed, and Recommendations 4, 5, 6, 13, and 14, with which they partially agreed, LSLA included plans to update and implement their written policies and procedures. Their responses address the OIG's findings. LSLA disagreed with Recommendations 1, 2, and 8, although their response and proposed actions for Recommendations 2 and 8 address the OIG findings. For Recommendation 1 and the findings with questioned costs related to LSC Disaster Grants, LSLA maintains that their current processes over LSC disaster grants are aligned with LSC guidelines and regulations. LSLA's responses are included in their entirety in Appendix IV.

OIG determined that LSLA's proposed actions address Recommendations 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, and 14. However, these recommendations will remain open until LSLA provides the OIG evidence of the strengthened policies and procedures detailed in Figure 4.

Figure 4: List of Supporting Documentation

| Recommendation No. | List of 13 Recommendations Remaining Open Pending Specified Documentation |
|---|---|
| **2** | The updated written policies and procedures to document key details, such as dates of office closures, impacted offices, and staff on administrative leave. |
| **3** | The updated written policy to recompete long-standing contracts every three to five years. |
| **4** | Documentation that LSLA implemented a process to ensure their procurement policy is being followed, including documentation of bids and justifications for sole-sourced contracts. |
| **5** | The updated procurement policy extending the contract signing authority to the Deputy Director and Chief Financial Officer, in addition to the Chief Executive Officer. |
| **6** | The updated cost allocation policy aligned with LSC requirements, including procedures for documenting subjective adjustments. |
| **7** | The updated cost allocation policy which includes the methodology for equitably allocating unrestricted funds. |
| **8** | The updated cost allocation policy, including detailed documentation of the procedures performed over the cost allocation methodology. |
| **9** | The updated credit card policy, including procedures for credit card usage, statement reviews, payment processes, and the credit card reconciliation process. |

| | |
|---|---|
| **10** | The updated written policies and procedures for board travel reimbursements establishing when per diem allowance limits can be overridden as well as the documentation requirements for review and approval of per diem overrides. |
| **11** | The updated budgeting and management reporting policies to include the timeline for preparing management reports, identification of known commitments, contents of income and expense report, support of projections by schedules that document assumptions used to arrive at final projected amounts, budget constructions from cost centers, format of management reports, and preparation of a budget to actual report or similar report containing the required information. |
| **12** | Documentation of the process for management's review of monthly reports, including signature and date. |
| **13** | The updated payroll policy, including procedures for reconciling labor costs with timekeeping records and ensures that paid time off is allocated proportionally based on hours worked across different funding sources. |
| **14** | The updated client trust funds policy that complies with the applicable legal requirements for unclaimed client funds and aligns with LSLA's actual practices. |

The OIG takes exception to LSLA's responses to Recommendation 1. During our fieldwork, LSLA acknowledged there were minimal leave hours included in case time requests and that some case time hours were mistakenly included in administrative leave hours. Furthermore, LSLA did not provide supporting documentation of review with detailed information for case, matter, supporting activity, and leave for Hurricane Laura and Winter Storm Uri, including clarification of how the discrepancies were resolved. The OIG also takes exception with LSLA's responses to the findings with questioned costs related to LSC Disaster Grants:

- *LADRC – Leave & Holiday Hours totaling $39,983 in Questioned Costs* - LSLA maintains that leave and holiday hours can be classified as direct costs for employees working directly on LADRC grant activities. LSLA did not provide new documentation to demonstrate proportional allocation of leave and holiday hours to the grant, such as reconciliations against labor cost distribution reports.
- *Incurred Costs Grant – Unallowable Expenses Totaling $287,624 in Questioned Costs* - LSLA asserted that all expenses were related to the designated disasters. They maintain that they reclassified expenses incurred in 2020 and 2021 from LSC Basic Field grants to the Incurred Costs Grant per LSC's guidance in grant FAQ. The support provided indicated that these expenses were incurred in 2022 unrelated to the designated disasters. LSLA did not provide new disaster-specific documentation for these expenses in their response.

- *Incurred Costs Grant – Leave Hours Totaling $110,425 in Questioned Costs* - LSLA maintains that leave hours qualify as direct costs because they were accrued while employees worked on disaster related activities and were coded directly to the disaster grants. LSLA did not provide reconciliations against labor cost distribution reports to reflect that the leave hours were proportionately allocated to the grant in their response.

Therefore, the OIG will refer Recommendation 1, and the questioned costs related to LSC Disaster Grants totaling $438,032, to LSC Management for further review and action.

Figure 5: Recommendations Table Summary

| Recommendations Referred to LSC Management | Recommendations Open | Recommendations Closed |
|---|---|---|
| 1 | 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, and 14 | None |

LSLA's comments on the recommendations are categorized as follows:

- Referred to LSC Management — The grantee does not agree to implement the recommendation; the recommendation will be referred to LSC Management for resolution.
- Open — The grantee agreed to implement these recommendations or provided proposed actions that will address the finding.
- Closed — The OIG confirmed that the grantee's corrective actions were implemented.

# Appendix I: Scope and Methodology

To achieve the audit objective, we identified, reviewed, evaluated, and assessed internal controls in:

- LSC disaster grants,
- contracting,
- cost allocation,
- credit cards,
- disbursements,
- budgeting and management reporting,
- payroll,
- client trust funds,
- property and equipment,
- derivative income
- employee benefits, and
- general ledger and financial controls.

We assessed controls in effect during the period January 1, 2022, through December 31, 2023, to ensure that costs were adequately supported and allowed under the LSC Act and LSC regulations.

To select our samples for testing, we used a non-statistical sampling methodology. We determined this methodology was appropriate based on the audit period and objective. Our results cannot be projected to the audit universe, and we do not intend to make inferences about the populations from which we derived our samples.

Figure 6: Sampling Methodology of Areas Reviewed

| Sampling Methodology | |
|---|---|
| *LSC Disaster Grants* | We applied a non-statistical sampling method tailored to the audit's objectives and timeframe for the LSC Disaster Grants. This approach cannot be extrapolated to the entire audit universe.<br><br>To test the appropriateness of expenditures to the LSC Disaster Grants, we judgmentally selected a sample of expenditures for review. For the LADRC disaster grant, we focused on the highest expense periods—December 2021, January 2022, and January 2023— and reviewed $42,722 in personnel expenses. We also analyzed detailed timekeeping records for six staff members over a collective 12 months, totaling $37,531 in salaries.<br><br>We found that leave and holiday hours were charged directly to the disaster grant as part of salaries. We expanded our sample to include all salaries |

| Sampling Methodology | |
|---|---|
| | totaling $141,000 to determine if the leave and holiday hours were proportionately allocated to the disaster grant based on hours worked.<br><br>In our analysis of the Incurred Costs Grant, we examined budget adherence and expenses totaling $866,761. We sampled high-salary months and selected records for 11 employees, totaling $27,319 in salaries.<br><br>Further review revealed incorrect charges for leave hours directly charged to the Incurred Costs Grant, prompting an expanded examination of all salaries totaling $579,136 to ensure compliance with LSC regulations. |
| *Contracting* | For our testing of LSLA's contracting procedures, we judgmentally selected eight contracts with payments totaling $1,360,824 over the audit period. We selected the sample based on totals charged to the contract, service types, and contracts we determined were high risk. |
| *Cost Allocation* | We evaluated LSLA's cost allocation methodology to assess whether it was reasonable and compliant with LSC guidelines and included adequate internal controls. We used a judgmental sampling methodology to select five grants that did not allow indirect costs to assess whether the grant terms were followed. We also judgmentally selected one month of allocations to determine how the indirect allocations were performed. Additionally, we selected two personnel whose salaries were considered indirect, two personnel whose salaries were direct, two non-personnel indirect expenses, and two non-personnel direct expenses for review. We also selected all quarterly allocations to LSC and state funds to verify that they were performed quarterly. |
| *Credit Cards* | We reviewed LSLA's written policies, procedures, and practices to determine if they had adequate controls over credit cards and are comparable to LSC regulations and guidelines.<br><br>From a total population of 35 credit card statements over the audit period, totaling $254,413, we judgmentally selected eight statements totaling $81,823 from two credit card servicing companies. From the first card servicing company we judgmentally selected 26 transactions totaling $48,734. Transactions were chosen based on large amounts, unfamiliar vendors, meals, airlines, hotels, office supplies, membership fees and to sample other general expenses. The other credit card servicing company had only four transactions and we tested all four transactions, totaling $1,182. We assessed the appropriateness of the expenditures and the existence of approvals and adequate supporting documentation. |
| *Disbursements* | To assess the appropriateness of expenditures and the existence of adequate supporting documentation, we reviewed disbursements made by LSLA for |

| Sampling Methodology | |
|---|---|
| | transactions other than credit cards and payroll. We judgmentally selected a sample of 90 disbursements for testwork, totaling $515,830.<br><br>The selected samples included high dollar value transactions and potentially risky or unallowable purchases, routine disbursements for employee reimbursements, and office supplies, among others. The sample represented about 2.5 percent of the $20,825,511 disbursed for transactions other than payroll from January 1, 2022 through December 31, 2023.<br><br>To assess the appropriateness of expenditures, we tested whether LSLA documented adequate approvals and reviewed invoices and supporting documentation, then traced the expenditures to the general ledger. We evaluated the appropriateness of those expenditures based on LSLA's internal policies, applicable laws, and regulations, and LSC grant agreements and policy guidance. |
| *Budgeting and Management Reporting* | We judgmentally selected a sample of five months from which to review management reports. We also reviewed the 2023 budget that was prepared and approved during the period under review. |
| *Payroll* | We reviewed LSLA's policies and procedures over payroll and found they were generally compliant with LSC regulations. We conducted interviews and we reviewed a sample of timesheets and payroll registers. We verified that pay rates matched salary authorization agreements, employee timesheets were consistent with payroll registers, and that their payroll processes were in line with LSC criteria.<br><br>We judgmentally selected two pay periods for testing and selected a judgmental sample of 17 current employees and four former employees. We selected employees based on their office location and position title. Due to a discrepancy involving manually calculated payroll checks (noted in our testwork), we selected 18 instances of manually calculated checks from 12 judgmentally selected pay periods for additional testwork. |
| *Client Trust Funds* | We selected a judgmental, non-representative sample of two months of bank statement reconciliations from all eight of LSLA's client trust accounts, which totaled 16 reconciliations, to determine if the accounts were properly reconciled for financial statement preparation. |
| *Property and Equipment* | We reviewed LSLA's policies and procedures for property and equipment. We interviewed staff involved in purchasing, tracking, and disposing of property and equipment. |

| Sampling Methodology | |
|---|---|
| | Additionally, we reviewed LSLA's most recent inventory of property and equipment, conducted in December 2023. We verified items in the LSLA's tracking lists at each office and traced a sample of items from their central office to the tracking list and vice versa. We also reviewed property disposals and related documentation as well as real property owned by LSLA, and fixed assets purchased during the audit period.<br><br>We reviewed LSLA's inventory and electronic device tracking records and selected 33 items for testwork. We also verified capitalized and electronic equipment by reviewing the general ledger and performing spot checks at LSLA's Houston office. We selected items for testwork based on category type, office location, price, and purchase date. We also assessed LSLA's processes over tracking non-capitalized assets that may contain sensitive information. |
| *Derivative Income* | We reviewed LSLA's policies and procedures over derivative income, discussed the recordation and allocation processes with management and key staff, and tested derivative income transactions.<br><br>We did not select a sample for derivative income but instead performed testwork on the entire universe of interest ($1,796) and attorneys' fees ($58,219) transactions. For interest income, we reviewed bank statements, the general ledger, and LSLA's policies. For attorneys' fees, we reviewed the same documents along with records from LSLA's timekeeping software and other supporting documentation. |
| *Employee Benefits* | Our review of employee benefits focused on LSLA's infrastructure and parking benefits. All staff received a $75 monthly infrastructure benefit to help offset the cost of remote work. Employees at select offices also received a $130 monthly parking benefit. We judgmentally selected payments from two pay periods for 17 current employees and four former employees to determine if the payments were consistent and followed LSLA's policies. |
| *General Ledger and Financial Controls* | We reviewed LSLA's written policies and procedures over general ledger and financial controls to determine if they had adequate controls and adhered to LSC's regulations and guidelines.<br><br>We selected a judgmental sample of bank reconciliations to ensure they were adequately performed and reviewed. Excluding client trust accounts, which were reviewed in that section of the audit, LSLA had 19 open bank accounts. We judgmentally selected 72 bank reconciliations for review. |

To understand the internal control framework and LSLA's processes over the areas mentioned above, we interviewed LSLA management and staff, and we reviewed LSLA's written policies and procedures. These included accounting and personnel manuals, and additional Board-approved policies setting forth current grantee practices.

To review and evaluate internal controls, we designed and performed audit procedures to obtain sufficient and appropriate evidence to support our conclusions over the design, implementation, and operating effectiveness of controls significant to the audit objective. We also conducted testwork, which included inquiries, observation, and the examination of source documents to determine whether LSLA's internal control system and policies and procedures complied with the guidelines in LSC's Financial Guide.

We assessed internal controls and compliance with laws and regulations necessary to satisfy the audit objective. We assessed the internal control components and underlying principles that we determined to be significant to the audit objective. However, because we limited our review to these internal control components and underlying principles, our review may not have disclosed all internal control deficiencies that may have existed at the time of this audit.

Additionally, we considered the necessity of evaluating information system controls. We determined that information system controls were significant to the audit objective. Therefore, we evaluated information system controls related to specific grantee operations, oversight, program expenditures, and fiscal accountability. Our internal control review included performing audit procedures related to information system controls to obtain sufficient, appropriate evidence to support and document our findings and conclusions on the implementation and effectiveness of LSLA's internal controls. We determined that no additional audit procedures relating to information system controls were needed.

Per government auditing standards, we assessed the reliability of LSLA's computer-generated data. We reviewed selected system controls and supporting documentation and conducted interviews, logical tests, and testwork including tracing and vouching amounts to and from source documents. We found the data were reasonably complete, accurate and consistent. Therefore, we determined the data were sufficiently reliable for the purposes of this audit.

We also assessed significance and audit risk. We determined that internal controls in the select financial and operational areas mentioned above were significant to the audit objective. Audit risk is the possibility that audit findings, conclusions, recommendations, or assurance may be improper or incomplete because of factors such as insufficient or inappropriate evidence, the inadequacy of the audit process, or intentional omissions or misleading information due to misrepresentation or fraud. Based on our consideration of these factors, we determined the audit risk level to be low.

We conducted the audit fieldwork remotely and on-site from February 5 to June 21, 2024. We performed the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objective. We believe the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objective.

# Appendix II: Assessment of Internal Control Components and Principles

Figure 7: Internal Control Principles Significant to the Audit Objective[18]

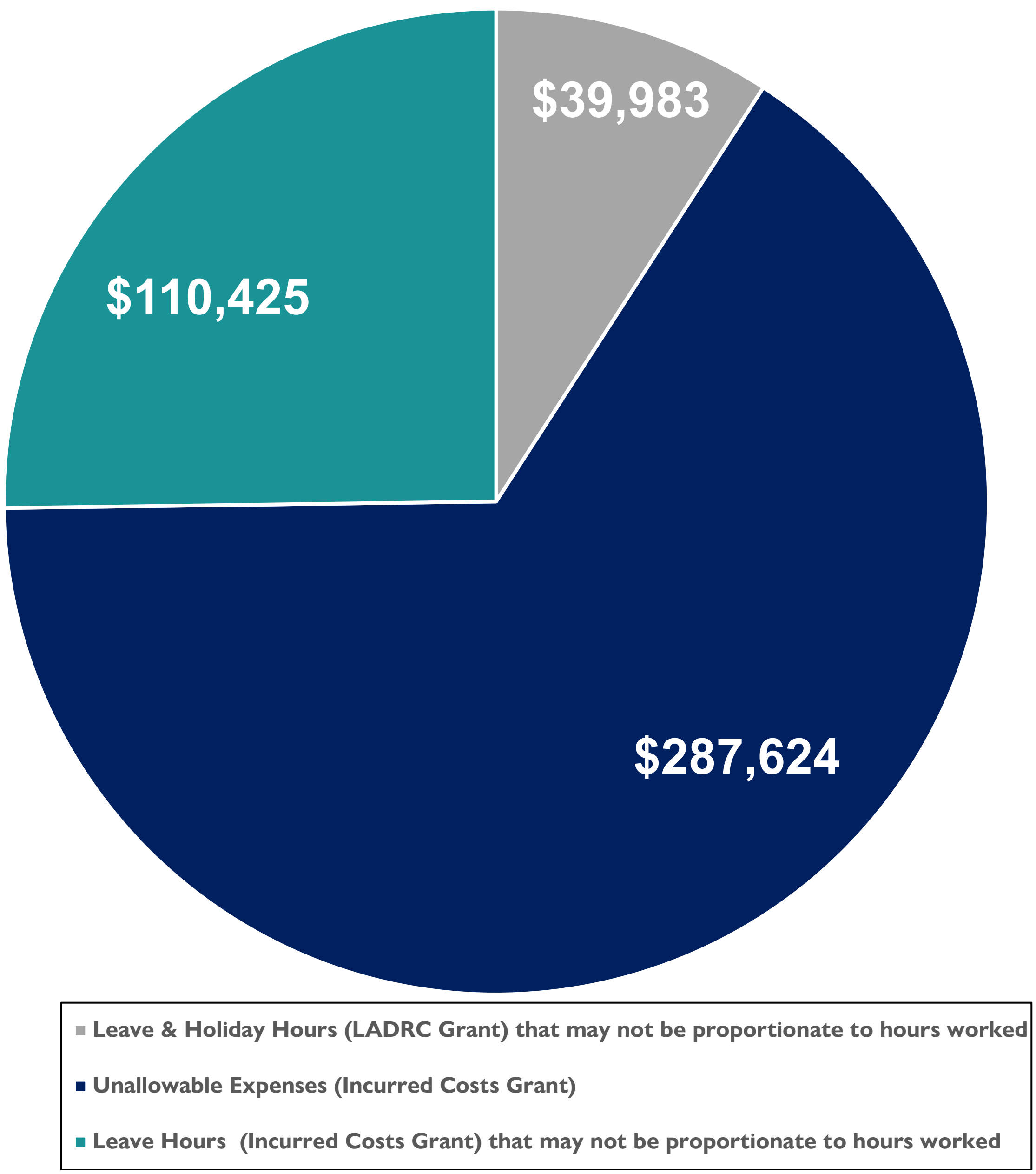
| Internal Control Component | | Principle | |
|---|---|---|---|
| **Name** | **Overview** | **Number** | **Description** |
| **Control Environment** | The control environment is the foundation for an internal control system. It provides the discipline and structure, which affect the overall quality of internal control. It influences how objectives are defined and how control activities are structured. The oversight body and management establish and maintain an environment throughout the entity that sets a positive attitude toward internal control. | 2 | The Oversight Body Should Oversee the Entity's Internal Control System |
| | | 3 | Management Should Establish an Organizational Structure, Assign Responsibility, and Delegate Authority to Achieve the Entity's Objectives |
| **Control Activities** | Control activities are the actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity's information system. | 10 | Management Should Design Control Activities to Achieve Objectives and Respond to Risks |
| | | 11 | Management Should Design the Entity's Information System and Related Control Activities to Achieve Objectives and Respond to Risks |
| | | 12 | Management Should Implement Control Activities Through Policies |

[18] The numbers correspond with the principles outlined in the Standards for Internal Control in the Federal Government (GAO-14-704G). While we considered principles 1, 4-9, 16 and 17 during the audit, we determined that these principles were not significant to the audit objective.

| Internal Control Component | | Principle | |
|---|---|---|---|
| **Name** | **Overview** | **Number** | **Description** |
| **Information and Communication** | Management uses quality information to support the internal control system. Effective information and communication are vital for an entity to achieve its objectives.<br><br>Entity management needs access to relevant and reliable communication related to internal and external events. | 13 | Management Should Use Quality Information to Achieve the Entity's Objectives |
| | | 14 | Management Should Internally Communicate the Necessary Quality Information to Achieve the Entity's Objectives |
| | | 15 | Management Should Externally Communicate the Necessary Quality Information to Achieve the Entity's Objectives |

# Appendix III: Summary of Impact, Findings, and Recommendations

Figure 8: Questioned Costs Related to the LSC Disaster Grants



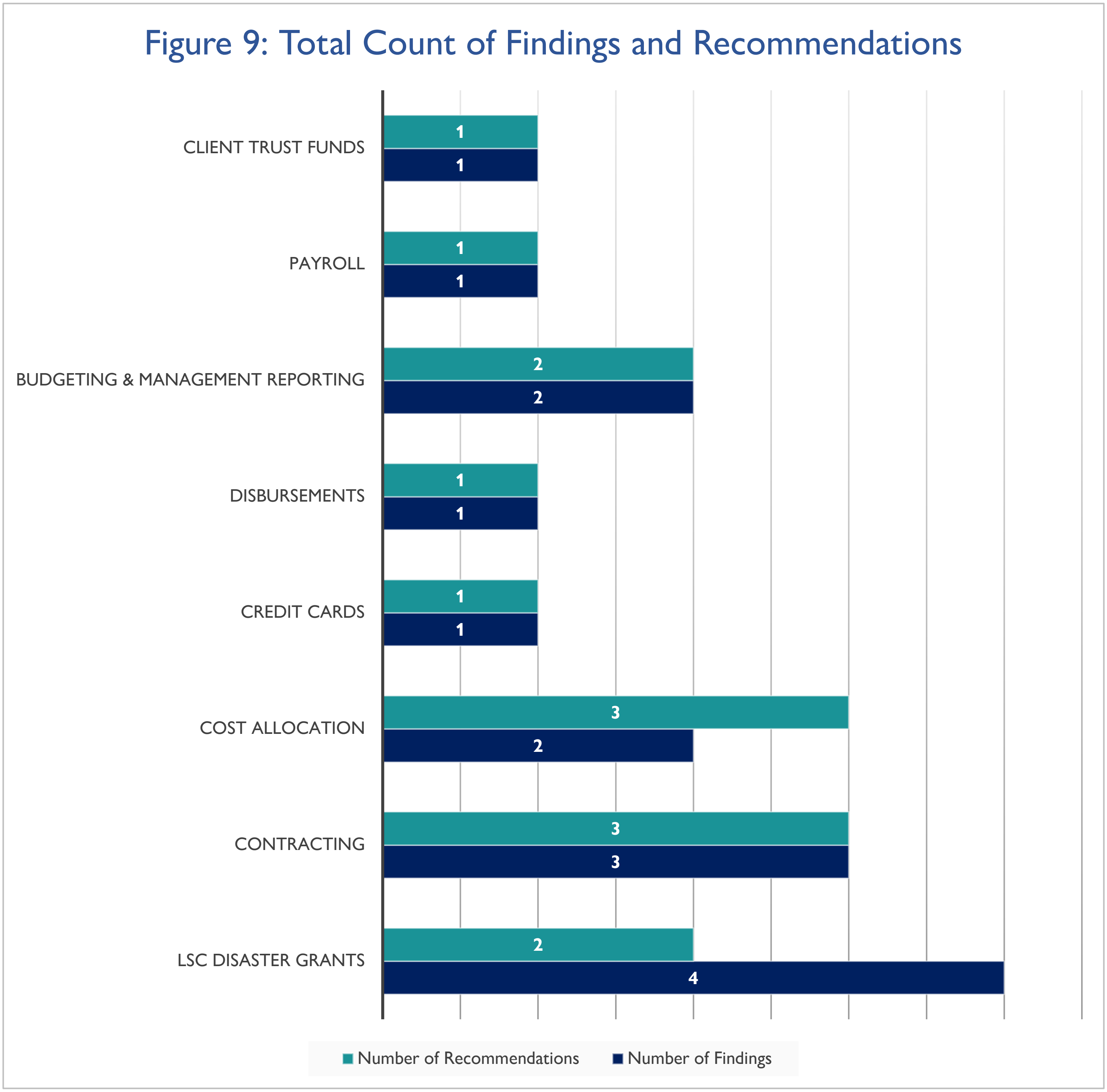


Figure 9: Total Count of Findings and Recommendations
CLIENT TRUST FUNDS
1
1
PAYROLL
1
1
BUDGETING & MANAGEMENT REPORTING
2
2
DISBURSEMENTS
1
1
CREDIT CARDS
1
1
COST ALLOCATION
3
2
CONTRACTING
3
3
LSC DISASTER GRANTS
2
4
Number of Recommendations
Number of Findings

# Appendix IV: Grantee Management Comments

**PAUL E. FURRH, JR.**
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January 15, 2025

Ms. Roxanne Caruso
Assistant Inspector General for Audit
Office of Inspector General
**LEGAL SERVICES CORPORATION**
1825 I Street NW, Suite 800
Washington, D.C. 20006

***Re: Lone Star Legal Aid's Responses to RNO 744060 Draft Audit Report on Selected Internal Controls***

Dear Ms. Caruso:

Please find attached Lone Star Legal Aid's responses to the findings and recommendations in RNO 744060 Audit Report on Selected Internal Controls. We appreciate the time and effort your staff and offices have put into this Audit. For the most part, we agree with your findings and recommendations and will use them to strengthen our financial practices.

We have responded extensively to the findings related to the Disaster Grants as there seems to be some confusion surrounding them and hope you will take another look at them as we believe we have provided good explanations to these findings. We paid particular attention to LSC grant instructions, Frequently Asked Questions, and LSC Program Letters. The Disaster Grants were and have been a Godsend to LSC funded programs experiencing disasters. We appreciate them and want to properly account for them. We believe we have appropriately allocated for all $866,761 of the grant in 2022 going back to 2020 and 2021.

Again, thank you for your assistance, particularly for granting us an extension to respond. We are still recovering from Hurricane Beryl which hit in the fall. Several of our staff are just getting back into their homes as a result of the Hurricane. We have been told to prepare for a storm/freeze next week that may be as severe as the 2021 Winter Storm Uri which wrecked real damage in LSLA's service area. Disasters like Hurricane Ike, Hurricane Harvey, and the recent ones have become a way of life for us.

Sincerely,

**PAUL E. FURRH, JR.**
Chief Executive Officer

PEF:rc
Attachment: ***LSLA's Responses to RNO 7744060 Draft Audit Report on Selected Internal Controls***

cc: Ms. Elizabeth Castillo, Senior Audit Program Analyst, LSC
Mr. Ernest W. Brown, Jr., Deputy Director
Ms. Robyn Rice, Chief Financial Officer, C.P.A.
Dr. Clen Burton, C.P.A., Chair, Audit Committee
Mr. Travis Wofford, Chair, Finance Committee
Mr. Paul Kruse, Finance Committee
Ms. Elizabeth Mata Kroger, Chair, LSLA Board of Directors

**PAUL E. FURRH, JR.**
Attorney at Law
Chief Executive Officer

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# Response to LSLA Draft Report on Selected Internal Controls of the LSC Office of Inspector General Visit February 05, 2024 – March 01, 2024 Recipient No. 744060

Lone Star Legal Aid (LSLA) submits this response to LSC OIG's Draft Report on Selected Internal Controls Visit, findings and recommendations.

***Recommendation 1***: ***We recommend the CEO perform a review of the Incurred Costs Grant budget application and timekeeping records related to the disasters from 2020 and 2021 to identify the actual hours worked and corresponding costs for case time and administrative leave hours for office closures. The review should clearly distinguish between distinct categories of hours, including actual case/matter/supporting activity hours and leave.***

*Response*:

- ***FINDING LADRC: Leave & holiday hours may not have been proportionately allocated based on hours worked – Legal Aid Disaster Resource Center Grant (LARDRC).***

    - *"LSLA charged $141,000 in salaries to the grant but incorrectly classified leave and holiday hours as direct costs. Leave and holiday hours are an employee benefit earned over time and the cost of these benefits cannot be readily identified with a particular final cost objective, especially if an employee works on various grant projects throughout the year."*

LSLA has reviewed this finding and believes that LSLA proportionately allocated leave and holiday hours charged to the LADRC grant. Consistent with LSC timekeeping requirements, each LSLA employee's time is recorded directly and proportionately to the specific grant worked by the employee during the period. Leave and holiday hours are calculated based on the specific number of hours directly and proportionately attributed to each grant, project, or activity. The hours are readily identified by the grant to which work and leave times are recorded. As such, the leave and holiday hours in question were correctly classified as a direct cost of the LADRC grant.

- ***OIG believes that LSLA's practices for coding leave and holiday hours do not align with LSC regulations and guidance:***

    - *LSC regulation 45 C.F.R. § 1630.5(e), which defines indirect costs as "those that have been incurred for common or joint objectives and* *cannot be readily identified with a particular final cost objective*.' We noted that leave and holiday hours are generally considered indirect costs because they are not attributable to a specific grant, project, or activity."

Leave time is a fringe benefit to employees and is a direct cost to a program for employees who are direct program staff. The example of a leave allocation within the LSC Financial Guide 2.2.3 is consistent with such. Although leave and holiday hours may be considered indirect costs in some circumstances, LSLA believes it correctly classified leave and holiday hours as direct costs for the LADRC grant. These costs were specifically recorded and attributable to the LADRC grant as evidenced by LSLA timekeeping procedures.

- *LSC regulation 45 C.F.R. § 1635.4(a) states that recipients must allocate salaries and wages based on records that accurately reflect the work performed.*

LSLA allocates salaries and wages based on records that accurately reflect the work performed and are consistent with LSLA policies and practices. LSLA reviewed this finding and believes it is in compliance with the LSC regulation.

- *The LSC Financial Guide, Section 2.2.3, which requires labor cost distribution reports to be reconciled against individual timekeeping reports. The guide provides an example of an attorney's salary that is funded by multiple sources and indicates that holiday and leave pay should be proportionally allocated to each funding source based on hours worked.*

LSLA relies upon detailed exacting time keeping records from Legal Server to allocate staff time to grants and proportionately calculate leave balances. Detailed time sheets from Legal Server are reconciled to ADP payroll records, all which were provided to the OIG team.

- **<u>FINDING INCURRED COSTS GRANT</u>: LSLA charged expenses to the incurred costs grant that were not related to the designated disaster.**

    - **"LSLA Charged Expenses to the Incurred Cost Grants That Were Not Related to the Designted Disasters."**

LSLA reviewed this finding and believes its expenses charged to the Incurred Costs Grant were directly related to Hurricane Laura in 2020 and to Winter Storm Uri in 2021. The expenses were incurred within the years 2020 and 2021, when the disasters occurred. Detailed supporting documentation for all allowable 2020 and 2021 disaster related expenditures exists and was provided during the audit.

The Incurred Costs Grant was awarded to LSLA on July 29, 2022. At the time the grant was awarded, LSLA 2020 and 2021 financial records for those years were closed. Audits for both years were completed and issued significantly before July 29, 2022. The relevant expenses related to the disasters were charged to the LSC Basic Field grants in 2020 and 2021 because the disaster grant funding had not been awarded when the expenses were incurred.

The following is an excerpt from the grant agreement. The grant agreement clearly names objectives that were paid for with 2021 funds yet includes start and end dates for the expenditures within 2022.

**Goal(s):**

| Goal ID | Goal | Description |
|---|---|---|
| GL-433 | To enhance legal aid capabilities to better serve survivors of 2020-2021 declared disasters | N/A |

**Objective(s):**

| Objective ID | Associated Goal ID | Name | Start Date | End Date |
|---|---|---|---|---|
| OBJ-1154 | GL-433 | Provide advice and legal representation to address disaster related legal issues for low-income survivors | 04/01/2022 | 10/01/2022 |
| OBJ-1155 | GL-433 | Make repairs to LSLA offices damaged during the February 2021 Winter Storms | 04/01/2022 | 10/01/2022 |
| OBJ-1156 | GL-433 | Recoup administrative leave paid to employees during business interruption caused by Hurricane Laura and the February 2021 Winter Storms. | 04/01/2022 | 10/01/2022 |

Upon receipt of the subsequent grant award on July 29, 2022, the question arose of the proper manner to record a grant within the financial records that was awarded after the expenses were incurred. From an accounting perspective, this presented several challenges. Recording the award in the year in which the expenses were incurred was not an option as 1) it is improper to record an award in period prior to the award being made, and 2) the 2020 and 2021 books were had been closed and audited. The 2022 award in the amount of $866,760.66 needed to be recorded as revenue yet also have equal expenses to offset the award in the same accounting year. LSLA consulted with its independent auditor and determined that the most appropriate treatment was to identify expenses of the same functional category (i.e. salaries, repairs, etc.) within the 2022 books and make general journal entries to move those expenses from the 2022 LSC Basic Field Grant to the LSC Incurred Costs Grant to effectively repay the LSC Basic Field Grant for the expenses it incurred in 2020 and 2021 that were now being paid for by the subsequent grant. To have not recorded expenses to offset the award would be "double-dipping" of funds as 2021 and 2020 LSC Basic Field Grants paid for the expenses incurred. We consulted with other audit firms with experience with non-profit auditing and federal grants and confirmed the appropriateness of our approach.

LSC specifically states in the grant application FAQs that "grantees will be expected to provide documentation of expenses incurred but will not be required to restate FY2020 or FY2021 audited financial statements to receive these funds." It went on to say, "once received, the Incurred Costs Grant funds will become LSC Basic Field Grant funds." Therefore, the recording of 2022 expenses to the cost center associated with Incurred Costs Grant was entirely appropriate as those expenses were 2022 allowable Basic Field Grant expenses. LSLA is in compliance with the requirement that grantees be expected to provide documentation of expenses incurred. LSLA has detailed records for every expenditure reimbursed under the Incurred Costs Grant.

An example described in the FAQs for the Disaster Supplemental Appropriation Grant supports LSLA actions and provides that:

> *Applicant incurred expenses in 2020 and 2021 for staff attorneys and paralegals to provide legal assistance and conduct outreach to survivors of an eligible disaster. Applicants Audited Financial Statements for 2020 and 2021 may already be completed.*

*LSC does not expect applicants to restate their FY2020 and FY2021 audited financial statements to receive Incurred Costs Grants. The Incurred Costs Grants are expected to reimburse grantees for expenses made with either unrestricted funds or LSC Basic Field Grant funds to respond to eligible disasters. Once received, the Incurred Costs Grant funds will become LSC Basic Field Grant funds and will be subject to LSC regulations. Grantees will be expected to provide documentation of expenses incurred but will not be required to restate FY2020 or FY2021 audited financial statements to receive these funds.*

The difference in accounting opinion occurred when the 2022 detailed general ledger for the LSC Incurred Costs Grant was requested by OIG. OIG expected to find expenses within that 2022 general ledger would be related to the disaster grants. That would not occur as those expenses were incurred in 2020 and 2021. As noted above from the FAQ, the Incurred Costs Grant would become LSC Basic Field Grant funds in 2022." LSLA management provided detailed support for the disaster expenses incurred in 2020 and 2021 that related to the disasters.

The $195,146 OIG questioned relates to the fringe benefits calculated in Exhibit 1 and Exhibit 2 incurred in 2020 and 2021 and relates directly to the fringe benefits paid to employees for their direct time related to the disasters.

The $5,591 within the 2022 detailed general ledger are appropriately recorded as 2022 expenses. Those are effectively repaying the LSC Basic Field Grant for $5,591 of expenses incurred in 2021 that related to the disasters. The 2020 and 2021 expenses incurred totaling $5,590.89 are supported by invoices and directly related to the disasters.

| Invoice Date | Vendor | Dollar Amount | Office | Description |
|---|---|---|---|---|
| 3/1/2021 | BETGU | 200.00 | Conroe | Emergency Call - Repair Copper Valve |
| 2/24/2021 | Nacogdoches Sheet Metal | 810.49 | Nacogdoches | Changed furnace board and gas valve |
| 2/10/2021 | Nacogdoches Sheet Metal | 354.40 | Nacogdoches | Replaced furnace ignitor and checked for working condition |
| 3/3/2021 | Roto Rooter Plumbing | 726.00 | Belton | Flush lines to remove rust/sediment and replace fill valves |
| 3/2/2021 | The Look Management | 3,500.00 | Conroe | Building repair due to burst pipes |

The award provided for 10% in indirect costs/overhead. The $86,887 of indirect expenses recorded within the 2022 detailed general ledger are 2022 indirect cost expenses that mirror the 2020 and 2021 indirect costs related to the 2020 and 2021 disasters (which were charged to the LSC Basic Field Grant in those respective years).

All expenses effectively charged to the Incurred Costs Grant are directly related to Hurricane Laura in 2020 and Winter Storm Uri in 2021. All $866,760.66 of the grant is supported by detailed documentation including time sheets and invoices. The $866,760.66 of disaster expenses incurred in 2020 and 2021 is as it appeared in Part I of the grant application that was submitted in Grant Ease (EXHIBIT 2).

**Recommendation 2**: ***We recommend the CEO implement a procedure to ensure that all relevant information, including the dates of office closures, offices impacted or closed, and staff on administrative leave due to disasters Hurricane Laura and Winter Storm Uri are adequately documented; and do so each time such actions are taken in response to future disasters.***

***Response***: LSLA will implement a procedure to ensure that all relevant information, including the dates of office closures, offices impacted or closed, and staff on administrative leave due to disasters Hurricane Laura and Winter Storm Uri are adequately documented; and do so each time such actions are taken in response to future disasters.

The grant application in Grant Ease clearly identified the request for reimbursement of administrative time related to office closures, as shown in the chart below.

| | |
|---|---|
| Laura - Case Time | 12,623.12 |
| Laura - Office Closure | 9,342.65 |
| Uri - Case Time | 343,917.64 |
| Uri - Office Closure | 213,252.66 |
| | **579,136.07** |

On April 18, 2024, LSLA emailed Meliza Ella (OIG), an Excel file named "URI and Laura Time" which has four tabs. The first two tabs are the timeslips related to the time charged for office closures, which agree to the amounts listed in the grant application and the grant award. The two tabs contain in aggregate 754 rows of time slips detailed by employee name, hours, date, and code of "LAURA SHUT TIME" or "URI SHUT TIME." The time sheets clearly indicate the offices impacted and the number and names of staff on administrative leave due to the disasters.

The second two tabs of the Excel document contained the time slips for the actual case time worked for both Laura and Uri. Each of those tabs totaled the amounts shown above of $12,623.12 and $343,917.64. The two tabs contain in aggregate over 20,000 rows of time slips detailed by employee name, hours, date, and the respective disaster.

The audit report states LSLA did not clearly distinguish hours worked on case, matter, supporting activity and administrative leave in the budget request submitted to LSC. LSLA refers OIG to the budget entered into Grant Ease and the Excel file emailed to OIG on April 18, 2024. The audit states LSLA submitted an inaccurate grant application. LSLA maintains detailed documentation for the amounts requested in the grant application. LSLA maintains that the grant application within Grant Ease clearly identifies the functional categories of expenses requested for reimbursement. (Exhibit 2)

LSLA also provided LSC OIG memorandums outlining office closures. These memorandums detailed the necessity of office closures due to risks associated with rising water, high winds, destroyed homes, impassable highways and roads, power outages lasting weeks or perhaps even months, and extreme weather conditions.

Program Letter 20-3 addresses the same concept of administrative leave as it related to COVID-19. LSC states "maintaining readiness is reasonable and necessary for LSC grant objectives." The letter also states "the health, safety, and stability of grantee staff and operations take precedence over most other considerations. Documented, deliberative decisions by grantees are presumptively reasonable absent clear evidence of fraud, intentional abuse, or excessive and unjustified waste. LSLA must close offices at times during disasters in order to maintain overall readiness to meet overall LSC grant objectives." The same concept must be applied to the safety and stability of grantee staff and operations during times of natural disasters.

The grant application FAQ states the grant was to support the delivery of legal services related to the consequences of hurricanes, wildfires, other extreme weather, and earthquakes that occurred in calendar years 2020 and 2021. The office closures and associated administrative leave time are a direct consequence of the disasters.

***Recommendation 3***: ***We recommend that the CEO revise LSLA's contracting policy to require recompeting recurring purchases and long-standing contracts every three to five years.***

***Response***: LSLA will update its policies during 2025 to include the requirement that long-term contracts are rebid every 5 years to ensure the best value.

***Recommendation 4***: ***We recommend that the CEO implement a process to ensure LSLA follows its procurement policy. This includes documenting bids for all applicable purchases. Additionally, sole-source justifications should be documented and approved.***

***Response***: LSLA will update its contracting policies during 2025 for the OIG recommendations. LSLA does overall follow a bid policy as evidenced by OIG's conclusion that the contracts sampled were maintained, completed, signed and payments were made according to contract terms. LSLA maintains that while OIG did identify some bids that were missing documentation or lacked sufficient sole-source documentation, those were isolated incidents that were few. It is important to note that given the geographic location of LSLA, we are all too often affected by natural disasters and sole-source justification related to contracts necessary for business continuity occur more often than they may in other geographic areas. Some sole-source justifications are self-explanatory in nature and should not require extensive documentation.

***Recommendation 5***: ***We recommend that the CEO implement a process to ensure unauthorized personnel do not enter into contracts on behalf of LSLA. Alternatively, if LSLA decides that it would be beneficial to allow more flexibility in contract approval authority, this should be formalized in the written policies and any deviations from the written policies should be adequately documented and approved.***

***Response***: LSLA's policies will be updated during 2025 to allow for additional signers of contracts as the current policy that only allows for the CEO's signature is not reasonable given the size of the organization. The contracts that were signed by someone other than the CEO were, in fact, authorized and subsequently delegated by the CEO. Oftentimes this was due to time constraints or delegation due to the signature due to the requirement by vendor it be through electronic means by the original point of contact (i.e., the employee who worked directly with the vendor through the bid process).

***Recommendation 6***: ***We recommend that the CEO ensure LSLA's written cost allocation policies are updated to fully align with LSC requirements. Subjective adjustments should be minimized, and the considerations resulting in those adjustments should be formalized in the policies.***

***Response***: LSLA will update its cost allocation policy to thoroughly document the procedures.

LSLA will update its policies during 2025 regarding the allocation of indirect costs to unrestricted funds and follow said policy.

One funder allowed for 19% indirect as opposed to the typical de minimis 10% indirect cost rate. The variance between the two rates was used to fund staff who would have otherwise been within the indirect cost allocation pool. LSLA disagrees that the allocation of the 9% differential was inappropriate as it was used for indirect costs.

***Recommendation 7***: ***We recommend that the CEO update LSLA's cost allocation methodology to ensure unrestricted funds are equitably included as a source to pay for indirect costs.***

***Response***: LSLA will update LSLA's cost allocation methodology to ensure unrestricted funds are equitably included as a source to pay for indirect costs.

***Recommendation 8***: ***We recommend that the CEO ensure LSLA allocates the maximum allowable indirect costs to all funding sources, as per LSC guidance.***

***Response***: LSLA will update its policies during 2025 to more thoroughly document the procedures performed over cost allocation.

LSLA's independent auditors opine on the overall financial statements annually, which includes the testing of expenditures and the allocation of them. LSLA's consistently receives unmodified, clean opinions. We have concluded that a third-party reviewer is able to adequately review.

LSLA makes subjective adjustments within individual functional expense categories. The net result would not affect the total indirect expense allocated to any one grant.

LSLA is limited to the allowed indirect cost rate by any grantor as per the grant agreement. An allocation basis that utilizes direct salaries does, in fact, exist by nature of the awarded indirect rate, which is almost always the 10% de minimis rate. Thus, labor distribution reports and personnel activity reports support the indirect cost allocations.

OIG did not request or test the process or support for the monthly reconciliation of salaries and wages charged to LSC grants which agrees to the general ledger. A monthly detailed allocation by employee exists and is supported by time sheets.

LSLA maintains that it follows LSC requirements.

***Recommendation 9***: ***We recommend that the CEO update the LSLA Accounting Manual to include policies and procedures surrounding card usage, statement reviews, payment processes and the credit card reconciliation process.***

***Response***: LSLA will update the Accounting Manual during 2025 to include policies and procedures surrounding card usage, statement reviews, payment processes and the credit card reconciliation process.

Credit card statement reviews and reconciliations are performed in detail monthly. OIG did not request to review the procedures of the reconciliation. The detailed credit card charges by line item are downloaded directly from American Express. Each line item is coded by a member of the Accounting Department and each receipt is obtained. Each receipt has proper approvals. The detailed allocation within Excel is reviewed by the Director of Finance or the Chief Financial Officer and then uploaded to the general ledger. Any credit card statement is filed and has all supporting documentation attached.

The payment process of the monthly American Express credit card follows the normal accounts payable process that is adequately documented within the LSLA Accounting Manual.

***Recommendation 10***: ***We recommend the CEO establish explicit written policies and procedures for board travel reimbursement policies. In addition, the policies should stipulate when per diem allowance limits can be overridden as well as the required documentation of review and approval.***

***Response***: LSLA will update its policies during 2025 to ensure there are explicit written policies over travel reimbursements and per diem limits as it relates to board member reimbursements.

LSLA has followed the same per diem limit override as is set forth for employees. In any instance in which the per diem limit policy was overridden it was approved by the CEO, Deputy Director, or CFO.

OIG did discover one unallowable charge however the 2023 books were not yet closed. LSLA was in the process of closing the books in preparation for the annual audit. LSLA immediately remedied the issue by receiving reimbursement from the Board member for the unallowable charge.

***Recommendation 11***: ***We recommend that the CEO revise LSLA's written policies to include the following details:***

- ***Timeline for preparing management reports***
- ***Identification of known commitments***
- ***Contents of the income and expense report***
- ***Support of projections by schedules that document assumptions used to arrive at final projected amounts***
- ***Budget constructions from cost centers***
- ***Format of management reports***
- ***Preparation of a budget to actual report or similar report containing the required information***

***Response****:* LSLA will update its policies during 2025 to adequately reflect the procedures and ensure compliance with the LSC Financial Guide.

However, LSLA maintains that its procedures are in compliance with LSC's Financial Guide, Section 2.6, as it does prepare the required reports. Each monthly financial packet consists of budget vs. actual, funding source budget vs. actual (grant billing sheets exist for each grant and reconcile to the general ledger) and monthly statement of cash on hand. Cash on hand is the first line item on the balance sheet which is at the forefront of the financial packet. Additionally, a cash flow projection is maintained and updated bi-weekly at a minimum.

***Recommendation 12***: ***We recommend that the CEO implement a process to document management's review of monthly reports. This should include a signature and date to denote the review and ensure compliance with LSC's Financial Guide.***

***Response***: LSLA will update its policies and procedures during 2025 to ensure that management's monthly financial review is properly documented. Monthly financial reports are reviewed by the CEO without exception. LSLA will ensure that the CFO signs and dates as preparer and that the CEO signs and dates upon receipt and review.

***Recommendation 13***: ***We recommend the CEO update the LSLA Accounting Manual to include policies for reconciling labor costs with timekeeping records, and to ensure that paid time off is allocated proportionally based on hours worked across different funding sources.***

***Response***: LSLA will update its policies and procedures during 2025 to reflect the processes in place. In practice, LSLA follows the LSC Financial Guide 2.2.3, however its policies can more adequately describe the process.

LSLA does NOT acknowledge that paid time off may not always be proportionately charged to grants, unless there are circumstances that do not allow such that are outside of LSLA's control. Should an employee change to a new project funding by a different funder upon one grant ending, it is impossible to allocate any accrued paid leave to a grant that is nonexistent anymore. The paid leave must be allocated to the grant that an employee is currently assigned.

***Recommendation 14***: ***We recommend that the CEO ensure LSLA's written policies reflect the actual practices in place and comply with the applicable legal requirements for unclaimed client funds.***

***Response***: As noted within the OIG audit report, bank reconciliations (client trust funds and otherwise) are prepared and reviewed by separate persons within the Accounting Department, providing for adequate segregation of duties. Only the CFO or Director of Accounting reviews bank reconciliations. The policies will be updated during 2025 to thoroughly clarify that a member other than the Director of Finance may prepare bank reconciliations.

LSLA will update its policies during 2025 to clarify the process for escheatment of client trust funds, which involves legal counsel's guidance and approval of initiating escheatment.

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## Recommendation Tracking

| | |
|---|---|
| Grantee Name: | Lone Star Legal Aid |
| RNO: | 744060 |

The Office of Inspector General makes recommendations for actions or changes that will correct problems, better safeguard the integrity of funds, and improve procedures or otherwise increase efficiency or effectiveness. We believe grantee management understands its own operations best and is in a position to utilize more effective methods to respond to our recommendations. We encourage these methods when responding to recommendations.

**Instructions**: Please complete this form with your comments and select whether you agree, partially agree, or disagree with the recommendations outlined in the draft report. Along with this form, submit a letter outlining your responses to our audit report.

| Recommendations | Response | Comments |
|---|---|---|
| Recommendation 1 | Agree ☐<br>Partially Agree ☐<br>Disagree ☒ | On April 18, 2024, LSLA emailed Meliza Ella (OIG), an Excel file named "URI and Laura Time" which has 4 tabs. The first two tabs are the timeslips related to the time charged for office closures, which agree to the amounts listed in the grant application and the grant award. The two tabs contain in aggregate 754 rows of time slips detailed by employee name, hours, date, and code of "LAURA SHUT TIME" or "URI SHUT TIME." The time sheets clearly indicate the offices impacted and the number and names of staff on administrative leave due to the disasters. |

| Recommendations | Response | Comments |
|---|---|---|
| | | The second two tabs of the Excel document contained the time slips for the actual case time worked for both Laura and Uri. Each of those tabs totaled the amounts shown above of $12,623.12 and $343,917.64. The two tabs contain in aggregate over 20,000 rows of time slips detailed by employee name, hours, date, case/matter/supporting activity hours and the respective disaster. |
| Recommendation 2 | Agree ☐<br>Partially Agree ☐<br>Disagree ☒ | Our current procedures include issuing a memorandum from the Chief Executive Officer or Deputy Director to all employees during disasters, outlining office closures and directives. Managers are instructed to contact their team members to assess their safety, provide updates on property damage or personal impact, and issue necessary instructions. These efforts are conducted to the extent possible, acknowledging the challenges posed by power outages, cell phone reception, and internet disruptions. Timesheets are also maintained to document administrative leave taken by employees.<br><br>Disasters like **Hurricane Laura** and **Winter Storm Uri** illustrate the magnitude of challenges in our service area:<br><br>• **Hurricane Laura (2020)**: Winds up to 150 mph caused widespread damage, leaving 700,000 Texans without power and displacing thousands of families.<br>• **Winter Storm Uri (2021)**: Record-breaking lows and power outages affected 4.5 million Texans, with burst pipes flooding homes and disrupting essential services.<br><br>While we have processes and procedures in place to address disaster-related events, it is often impossible to predict how clients and staff will be affected. Each disaster brings unique challenges, making it difficult to account for every variable in advance. That said, we are committed to enhancing our approach by updating our processes and procedures to document key details, such as dates of closures, impacted offices, and staff on administrative leave, in a centralized and consistent manner. This will strengthen our ability |

| Recommendations | Response | Comments |
|---|---|---|
| | | to respond to and document the unpredictable nature of disaster impacts in the future. |
| Recommendation 3 | Agree ☒<br>Partially Agree ☐<br>Disagree ☐ | LSLA will set forth a formal policy to recompete long-standing contracts every five years. Additionally, LSLA will document thoroughly the bid process and ultimate selection of vendor. |
| Recommendation 4 | Agree ☐<br>Partially Agree ☒<br>Disagree ☐ | LSLA will improve processes to ensure compliance with the procurement policy, as well as outline the necessary documentation for a sole source justification. LSLA will implement a policy that CEO, Deputy Director or CFO have properly approved of any sole source justification. However, it's important to consider that LSLA resides in counties frequently impacted by federally declared disasters that cause profound damage. Sole source justifications may be more frequent due to that alone. |
| Recommendation 5 | Agree ☐<br>Partially Agree ☒<br>Disagree ☐ | LSLA agrees that four contracts were signed by someone other than the CEO, however the CEO was aware of the signing of those contracts. The CEO delegated the signing authority for those contracts due to logistical reasons. As LSLA has grown significantly over the last 10 years, the policy that the CEO sign all contracts must be reviewed and reconsidered for practicality purposes. LSLA will review its policies and will likely extend signing authority to the Deputy Director and Chief Financial Officer, in addition to the CEO. |
| Recommendation 6 | Agree ☐<br>Partially Agree ☒<br>Disagree ☐ | LSLA adheres to the guidance outlined in **Program Letter 24-4** and **45 CFR Part 1630**, ensuring that sufficient documentation exists for LSC and third-party reviewers to follow the cost allocation process from start to finish. Our auditors annually audit and opine on the financial statements, including Federal and State expenditures, which encompass the indirect cost allocation process. These audits confirm the |

| Recommendations | Response | Comments |
|---|---|---|
| | | transparency and accuracy of our processes. Additionally, LSLA's Chief Financial Officer has reviewed the cost allocation process in detail with OIG team members on multiple occasions, and they have also confirmed their ability to follow the process from start to finish.<br><br>While some subjective adjustments are made within functional expense categories, these do not result in any change to the net expenses charged to any grant. Each grant, other than the LSC Basic Field Grant, allows a predetermined amount of indirect costs, often capped at the de minimis rate of 10%. Allocations to these grants are therefore limited by the thresholds set within the respective grant agreements. Remaining overhead expenses are then allocated proportionately between the LSC Basic Field Grant and TAJF BCLS. Importantly, while the allocation of individual expense line items between these two grants may involve some subjectivity, it does not alter the total amount of costs allocated to these grants.<br><br>We agree that LSLA's written policies could more thoroughly outline these procedures and considerations. To address this, we will update our cost allocation policies during 2025 to ensure they fully align with LSC requirements. |
| Recommendation 7 | Agree ☒<br>Partially Agree ☐<br>Disagree ☐ | Due to the immateriality of the dollar value of unrestricted funds, LSLA failed to properly allocate indirect costs to such funds. LSLA will include within the policies and procedures such allocation. |
| Recommendation 8 | Agree ☐<br>Partially Agree ☐<br>Disagree ☒ | LSLA encountered one grant in which the funder awarded 29% indirect costs within the budget of total direct costs rather than the typical 10% de minimis indirect cost rate. LSLA utilized 10% of the award to account for indirect costs |

| Recommendations | Response | Comments |
| --- | --- | --- |
| | | in the form of general overhead as typically done. LSLA utilized the remaining 19% of the award to allocate to a staff person who worked on the grant. The staff person would've otherwise been charged to another grant as overhead. As such, LSLA maintains that while this staff person's time was identified, the 19% was, in fact, an indirect cost. In summary, the full 29% of indirect costs awarded by the funder was used towards overhead costs.<br><br>It is uncommon that a funder would award more than the 10% de minimis indirect cost rate. This situation was highly unusual. |
| Recommendation 9 | Agree ☒<br>Partially Agree ☐<br>Disagree ☐ | As per OIG's language in the draft audit report dated November 2024, LSLA management determined it was prudent to await the results of said audit before undertaking the time-consuming task of rewriting policies and procedures.<br><br>As such, LSLA does agree that updating the LSLA Accounting Manual to include policies and procedures related to credit cards is necessary and will be completed in 2025. |
| Recommendation 10 | Agree ☒<br>Partially Agree ☐<br>Disagree ☐ | LSLA agrees that the written policies regarding board member travel can be more robust to clearly outline the items addressed in the audit report. As the audit report suggests, sometimes board members are reimbursed based on actual expenses incurred and other times they're reimbursed based on per diem. The employee reimbursement policy does clearly allow for an override by the CEO, Deputy Director or CFO of per diem reimbursement for actual expenses incurred. That practice was extended to board members but was not as clearly outlined in the policies. LSLA will update the policies |

| Recommendations | Response | Comments |
|---|---|---|
| | | surrounding board travel reimbursement to be clearly adherent to the LSC Financial Guide in 2025. |
| Recommendation 11 | Agree ☒<br>Partially Agree ☐<br>Disagree ☐ | LSLA will revise its policies to include the details outlined in the OIG audit report with regard to Budget and Management Reporting in 2025. |
| Recommendation 12 | Agree ☒<br>Partially Agree ☐<br>Disagree ☐ | LSLA will implement a process for which management's review of monthly reports is documented with a signature and date in 2025. |
| Recommendation 13 | Agree ☐<br>Partially Agree ☒<br>Disagree ☐ | LSLA will update its Accounting Manual to include policies for reconciling labor costs with timekeeping records and to better outline its procedures for ensuring paid time off is allocated proportionately based on hours worked across different funding sources in 2025. |
| Recommendation 14 | Agree ☐<br>Partially Agree ☒<br>Disagree ☐ | As noted within the OIG Audit Report, LSLA made the decision to delay rewriting policies and procedures after the LSC Financial Guide was updated until the OIG Audit Report was issued to ensure comments were properly addressed in 2025. The intent of the currently written LSLA Accounting Manual is to ensure there is adequate separation of duties and review of bank reconciliations. The policy is clear that one member of the Accounting Department who is not involved in cash receipts prepares the bank reconciliation timely on a monthly basis and the reconciliation is reviewed by a manager withing the Accounting Department. There was never a deviation of such.<br><br>As it relates to general accounts payable, state escheat laws govern the disposition of unclaimed client funds. |

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|---|---|
| **Name and Title** | Paul E. Furrh, Jr., Chief Executive Officer |
| **Signature** | |

# Acronyms, Abbreviations, and Glossary

| Acronyms and Abbreviations | |
|---|---|
| *CEO* | Chief Executive Officer |
| *CFO* | Chief Financial Officer |
| *C.F.R.* | Code of Federal Regulations |
| *LADRC* | Legal Aid Disaster Resource Center |
| *LSC* | Legal Services Corporation |
| *LSLA* | Lone Star Legal Aid |
| *NOFA* | Notice of Fund Availability |
| *OIG* | Office of Inspector General |

| Glossary | |
|---|---|
| *Derivative Income* | Income derived from an LSC grant, such as interest income or rent, or the proportion of any reimbursement or recovery of direct payments to attorneys, proceeds from sale of assets, or other compensation or income attributable to any Corporation grant. |
| *Cost Allocation* | A process of assigning costs to specific funding sources, including LSC. |
| *De Minimis* | Under Uniform Guidance, de minimis refers to an indirect cost rate of 10 percent of modified total direct costs that can be used without a negotiated indirect cost rate. This rate is intended to simplify cost allocation for entities that may not have the resources to establish a formal indirect cost rate. |
| *Disbursements* | Cash payments made by the grantee; these can include checks and electronic transfers. |
| *Budgeting and Management Reporting* | Financial plan to allocate resources and provide a system of evaluation and control. Financial reports to help the Board and grantee management make financial decisions and report to funders. |
| *Incurred Costs Grants* | A grant wherein the grant recipient is reimbursed for expenses that have already been incurred in the execution of a project or program. |