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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

March 5, 1999

The Honorable Jonathan Lippman
Chief Administrative Judge
Office of Court Administration
Agency Building 4
Empire State Plaza
Albany, NY 12223

Re: Lawyers for Children, Inc.
Report 96-R-9

Dear Judge Lippman:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we audited the books and records of Lawyers for Children, Inc. (LFC), for the period of April 1, 1995 through March 31, 1996. Our audit related to reimbursements claimed by LFC under contract C-400043 awarded by the New York State Office of Court Administration (OCA).

The objectives of our financial-related audit were to determine whether costs claimed by LFC were allowable, had been documented adequately, and had been incurred for services funded under the contractual agreement we audited. To accomplish these objectives, we reviewed the contractual agreement, LFC's books and records of revenues and expenditures, internal controls over charges to the contract, and the level of LFC's compliance with contractual terms.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of LFC that are included within our audit scope. Further, these standards require that we review and report on LFC's internal control structure and its compliance with those laws, rules and regulations that are relevant to LFC's operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions,

and recommendations.

In planning and performing our audit procedures, we considered LFC's internal control structure. Our consideration was limited to a preliminary review of this structure that would enable us to understand the control environment and the way in which transactions flowed through the systems supporting LFC's claims. Because we did not intend to rely on the internal control structure in performing our work, our assessment did not extend beyond the preliminary review phase. Instead, we appropriately extended our substantive audit tests.

In conducting our audit, we performed tests of LFC's compliance with certain terms of the contract. Our objective in performing these tests was to obtain reasonable assurance about the allowability of amounts LFC received from OCA, not to provide an opinion on LFC's overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, LFC complied in all material respects with the provisions referred to in the preceding paragraph, except as noted in Section B of this report. With respect to the items not tested, nothing came to our attention that caused us to believe that LFC had not complied, in all material respects, with those provisions.

A. Background and Contract Terms

Founded in 1984, LFC is a not-for-profit organization located in New York City that is dedicated to representing children in foster care. Under New York State law, a child who has come into the Foster Care Program through neglect or abuse proceedings is to be assigned a lawyer by the Court. Children who are placed into foster care voluntarily have no such mandated legal representation. According to LFC, more than 8,000 of the 50,000 children in foster care are signed in by their parents or guardians; the result is that many children are not represented in the court proceedings that determine where and with whom they will live. Although the majority of LFC's caseload consisted of children voluntarily placed in foster care, OCA asked LFC in October 1990 to increase that load by adding cases in which children are involved in abuse, neglect, termination-of-parental-rights, and custody proceedings before the Court.

An LFC lawyer and a social worker with experience in child advocacy work together on each case the organization handles. In addition, child psychologists and psychiatrists are engaged on a case-by-case basis to provide expertise in child development and evaluation. The social workers interview and investigate the appropriate options for each child, contacting family and friends and meeting with potential caretakers. Based on their investigations, the attorneys then present a plan to the Court. When family reunification and preservation are planned, the social workers devise service plans intended to meet the needs of each child. The plans include arrangements for homemaking services, housing assistance, individual and family counseling, and parenting-skill classes.

The majority of LFC's funding is provided through the annual contract with OCA (e.g., 77 percent of LFC's funding in fiscal year 1995-96). Contributions and grants from individuals,

foundations, and corporations are LFC's other funding sources. Contract C-400043 requires that LFC use such other revenues first and refund any excess State payments. The contract includes, and both parties agreed to, the number of budgeted positions and the related salaries, as well as other-than-personal-service expenses being funded by the State. Certain adjustments to the contract budget require OCA's prior written approval.

B. Results of Audit

As discussed below and detailed in the attached exhibit, we determined that OCA is due a $133,352 refund from LFC, primarily because LFC claimed payroll expenses that exceeded the approved budget. We also made some observations regarding LFC's financial-management practices.

1. Audit Disallowances

a. Salaries and Fringe Benefits

The contract states that LFC may not increase the total number of positions, or adjust budgeted salaries by more than 5 percent without the prior written approval of OCA. Our audit disclosed that LFC had exceeded its approved personal service budget by $182,995. Without the written approval of OCA, the organization had added two new positions - - a Director of Community Outreach and a Secretary/Receptionist/Clerk - - and had claimed salaries for them totaling $82,033. LFC also adjusted the salaries of several employees by more than 5 percent without receiving prior written permission from OCA. Two examples follow:

Title	Budgeted	Claimed	Overclaimed
Managing Director	$83,254	$90,308	$7,054
Staff Attorney/Director of Development	$51,602	$59,066	$7,464

The final claim for contract C-400043 that LFC submitted to OCA clearly delineated the approved budget and the actual expenses. Although the contract requires OCA's prior written approval for such adjustments, OCA took no actions regarding the adjustments. LFC was able to absorb these additional costs because its actual other-than-personal-service expenses were less than budgeted and its other revenues exceeded budget. The contract requires that LFC use its other revenues first and refund any excess State payments, rather than increase contract expenses without prior approval.

The contract also requires that LFC report (claim) the actual expenses it incurred during the contract period. We reviewed LFC's payroll reports and found that it claimed $3,112 in salaries that exceeded employees' actual salaries. In some instances, the claimed salary

exceeded both the budgeted and the actual salary. In those instances, we disallowed the greater of the claimed salary over the actual salary, or the claimed salary over the budgeted salary. Overall, claimed salaries in excess of budget and in excess of actual cost totaled $185,232.

LFC claimed fringe benefits based on its actual fringe benefit costs. LFC's fringe benefit package included Social Security, Medicare, unemployment insurance, and health insurance. We determined that the claimed fringe benefit expenses related to the above overclaimed salaries totaled $22,134.

LFC officials disagreed with our observation that the State is due a refund because claimed salaries exceeded the approved budget. According to LFC officials, expenditures ". . . were approved by OCA in accordance with a mutually agreed upon pattern and practice which modified the terms of the written contract between OCA and LFC." However, the contract stipulates that the terms and conditions contained in the contract ". . . represent the full understanding of the parties and no part hereof shall be deleted or changed without the express written consent of both parties." During the audit, an OCA official informed us that, "I have no record of having approved any modifications to the original contract budget. So, then, the budget would presumably be the original budget." This OCA official also wrote us that, although he had received documents from LFC indicating that its staff were being paid higher salaries, he had no record of having approved the changes.

In response to a preliminary copy of this report, OCA's Director of Internal Controls stated, "The report correctly points out that LFC should have sought OCA approval for a variety of budgetary interchanges in which they had exceeded their approved budget allocations. However, the report omits the significant fact that LFC, through its private fund-raising, generated the funds needed to cover the noted over-spending. Since private revenue had been used, it is our view that it would be inappropriate to seek a refund of such monies." However, only about one-half of the overclaimed salaries were funded by the additional other revenues, which totaled $90,575. The balance was funded by LFC overbudgeting its other expense categories. For example, LFC budgeted fringe benefits at a rate of nearly 25 percent of salaries, yet it claimed fringe benefits at a rate of nearly 18 percent. Had LFC budgeted fringe benefits correctly, the budget would have been about $210,000, rather than $290,000.

In recognition of LFC's additional fund raising activities and the OCA official's observations related to it, we have reduced the $185,232 salary and $22,134 related fringe benefits overclaims by a total of $90,575, the amount of the additional revenues. The resulting net personal services and fringe benefits disallowances total $116,791 (OCA's Director of Internal Controls further assured us that the current contract with LFC has been amended and OCA's operating procedures have been altered to prevent any re-occurrence of this problem.)

b. Interest Expense

LFC claimed $9,254 for interest expense within the category "Contractual

Services." We disallowed the entire claim of $9,254 because interest expense was not an allowable contract cost. The contract does not include a budgeted line item for interest expense. In addition, general contract cost principles for nonprofit contractors cite interest expense as an unallowable cost. The Federal Office of Management and Budget (OMB) Circular A-122, "Cost Principles for Non-Profit Organizations" Attachment B.19, states that "Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable." This charge was also an unnecessary expense. Interest expense would not have been incurred had LFC stayed within the contract budget and properly managed its funds. LFC incurred the interest expense primarily because it increased salaries above the amounts that were budgeted, and not because OCA delayed its payments under the contract. OCA did pay the contract advance late in the first quarter of the year; however, during the same period LFC made non-interest-bearing loans and advances to its staff and others (see Section B-2 of this report).

c. Office Supply Expense

LFC claimed $11,452 in office supply expense within the expense category "Supplies and Materials." We reviewed LFC's records for each office supply expense item that exceeded $100 and found an expense of $520 that was not supported by sufficient documentation. In addition, one of LFC's managing directors donated money to LFC for a changing table costing $269. The cost of this table was charged to office supply expense, but the offsetting revenue (donation) was not reported. We disallowed these two expenditures totaling $789. We also disallowed an overclaim of $249 in this account.

d. Transportation Expense

LFC claimed $14,596 for transportation expense within the "Travel" expense category. Our review of LFC's records found that $1,014 of the transportation expense claimed did not have adequate supporting documentation, such as paid invoices. As a result, we disallowed the $1,014.

e. Insurance Expense

LFC claimed $22,624 for insurance expense within the expense category "Contractual Services." We reviewed LFC's insurance invoices and canceled checks and found that the allowable insurance expense totaled $20,593. We disallowed $2,031 of the insurance expense that was claimed for an automobile that was not program-related.

f. Professional Services

LFC claimed $7,960 for consultant services within the expense category "Professional Services." We are disallowing $255 of these expenses because LFC could not provide adequate documentation supporting them.

g. Revenue

LFC receives revenues from individuals, foundations, and corporations through its fund-raising activities. The contract requires LFC to report all revenues received during the contract period. Our review disclosed that LFC did not report $647 in interest and miscellaneous income that it received during the contract period. We added this amount to LFC's "Other Revenue" when calculating the refund due to the State.

2. Loans and Salary Advances

LFC's Certificate of Incorporation states, "No part of the net earnings of the corporation shall inure to the benefit of or be distributable to its directors or officers or to other private persons . . ." During the period from October 1993 through March 1996, we determined that LFC made a total of $37,595 in non-interest-bearing loans to one of its two managing directors. This Managing Director also served as a Board member. The loans included $4,325 for car lease expenses and $5,020 for car service expenses for the Managing Director's personal transportation. As of July 24, 1997, the Managing Director owed LFC $7,032. We also found that on November 9, 1995, LFC lent $300 to its Administrative Director, which was repaid on April 30, 1996.

From April 1, 1995 through March 31, 1996, LFC made 42 salary advances totaling $55,677 to one of the managing directors, the Administrative Director, and nine other employees. For example, on October 18, 1995, LFC advanced the Managing Director's salary for the biweekly pay periods that ended on November 17, December 1, and December 15, 1995. We also observed that, on August 17, 1995, LFC lent $2,500 to a third party who was unrelated to LFC. The loan agreement required that the loan be repaid by August 17, 1996. As of April 15, 1997, a balance of $1,750 remained outstanding on this loan.

LFC does not maintain adequate records to account for the loans and salary advances. The loans to employees are generally not evidenced by loan agreements, and LFC does not charge any interest expense for the loans. In addition, the LFC Board of Directors did not approve these loans or salary advances. The Internal Revenue Code Section 501(c)(3) provides Federal income tax exemption for organizations that operate for charitable purposes, on the condition that the organization serves the public rather than private interests. One or more of the transactions described in this section could place LFC's Federal tax-exempt status at risk.

3. Other Financial-Management Matters

The contract requires that LFC supervise and oversee the conduct and performance of those employed by LFC to fulfill its contractual responsibilities. We found that LFC did not segregate the duties of its employees properly or monitor its employees' time and attendance practices adequately.

a. Segregation of Duties

Good internal controls require that employees who have access to assets, such as the organization's check book, should not have access to the accounting records related to those assets. When functions are not separated adequately, there is a greater opportunity for irregularities to occur. We found that LFC's Administrative Director has complete control over all aspects of the accounting system. She posts all entries to the accounting records, signs all the checks, deposits the checks received into the bank, and performs the bank reconciliations. There is no segregation of duties at all. To illustrate the seriousness of this lack of controls, we reviewed checks valued at more than $100 that had been issued by LFC during the contract year. We identified four checks totaling $2,426 that the Administrative Director had made payable to herself for salary advances. We also found that 56 of the checks, with a total value of $38,076, were payable to "Cash" and signed by the Administrative Director; 53 of these checks had been endorsed by the Administrative Director. These checks were used primarily to purchase subway tokens and fast-food coupons for children's meals. (LFC officials responded that this situation has been addressed; a part-time bookkeeping consultant has been hired to handle bank reconciliations and other bookkeeping responsibilities.)

b. Time and Attendance

Proper internal controls over time and attendance should ensure that there is an adequate system in place for tracking the time that employees take off from work. LFC records employees' attendance, work locations, and absences on daily location sheets. Attendance information is then transferred to each employee's time log sheet. We reviewed the daily location sheets and time log sheets for a 3-month period for 28 LFC employees. We found that the daily location sheets did not completely indicate the 28 employees' whereabouts on 78 of the workdays covered by the records. The daily location sheets showed that the 28 employees were absent for 260 days during the quarterly period. However, the time log sheets reflected just 185 (71 percent) of these absences.

Time log sheets were not maintained for LFC's two managing directors. We reviewed the daily location sheets for an 11-month period for both, and noted a large number of absences for one of the two. The daily location sheets indicated that one Managing Director was absent from work for 55 days, and that her whereabouts were not documented for an additional 22 days. (LFC officials responded that they have been testing a new system for recording employee time and attendance that should address our concerns.)

Another control weakness we noted was that employees are allowed to carry "negative" sick and vacation leave balances without any repercussions to their pay. For example, the records showed that, although three of ten employees had negative vacation leave balances when they left their LFC jobs, just two of the employees' final paychecks had been reduced properly. (LFC officials responded that one employee made up the negative vacation leave balance by working after her formal employment at LFC had ended, and the other employee used

available sick leave to offset the vacation days.)

These practices occur partly because LFC does not have a policies and procedures manual instructing staff about its requirements and expectations.

c. Personnel Records

An organization should develop job descriptions, recruit qualified people, and perform background and resume checks to ensure compliance with its standards. At a minimum, employee personnel records should contain a resume, references, and a copy of the employee's job description and qualifications. LFC does not have written job descriptions for its employees. We examined the personnel records for 29 LFC employees, including 12 attorneys. Six (21 percent) of the 29 files did not contain the employees' resumes. We found that the files for eight of the attorneys included in the contract claims did not contain evidence of their law degrees. One of the managing directors informed us that she had verified these attorneys' qualifications by telephone, but did not maintain any written documentation. We reviewed OCA's records to determine whether the attorneys had, in fact, been admitted to the New York State Bar. OCA's records showed that they had been admitted to practice law in New York State. (LFC officials responded that they will review all personnel files to ensure that they are complete.)

Recommendations

1. *Obtain a $133,352 refund from LFC.*

2. *Take actions to ensure that the approved budget amounts are reasonable and expenses are claimed in accordance with the approved budget and are documented properly; and require that modifications to the budget are approved in writing by OCA in accordance with the contract.*

3. *Take actions to ensure that all revenues are reported in the year received.*

4. *Require LFC to stop the practice of providing loans and salary advances.*

5. *Require LFC to segregate job responsibilities properly.*

6. *Take actions to ensure that LFC prepares a policies and procedures manual and distributes it to employees.*

7. *Take actions to ensure that LFC accurately maintains time and attendance records for all employees.*

8. *Take actions to ensure that LFC develops job descriptions and that it documents verification of its employees' qualifications.*

Major contributors to this report were Kenneth Spitzer, Debra Wolrich, Mitch Schmeltzer, Aurora Caamano, Joseph Giaimo, and Rodney Washington.

We would appreciate receiving your written response to the report recommendations within 30 days, indicating any actions planned or taken to implement them. We wish to thank the management and staff of Lawyers for Children, Inc., and the Office of Court Administration for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Frank J. Houston
Audit Director

cc: Robert L. King
Dennis W. Donnelly, CPA
Karen Friedman, Esq.

LAWYERS FOR CHILDREN, INC.
CONTRACT C-400043
SUMMARY OF EXPENSES BUDGETED, CLAIMED, DISALLOWED AND ALLOWED
APRIL 1, 1995 THROUGH MARCH 31, 1996

Category	Budgeted	Claimed	Disallowed	Allowed
Personal Services	$1,164,941	$1,332,138	$104,361 [a]	$1,227,777
Fringe Benefits	290,000	237,256	12,430 [b]	224,826
Supplies & Materials	17,000	19,577	1,038 [c]	18,539
Travel	21,000	16,923	1,014 [d]	15,909
Contractual Services	274,500	261,668	11,285 [e]	250,383
Professional Services	65,000	55,559	255 [f]	55,304
Equipment & Books	12,000	8,926		8,926
Total Expenses	$1,844,441	$1,932,047	$130,383	$1,801,664
Less: Other Revenue	397,373	487,301	(647) [g]	487,948
Net-Reimbursable Expenses	$1,447,068	$1,444,746	$131,030	$1,313,716
State Payments				1,447,068
Refund due the State				$133,352

Notes:

[a] Represents claimed salaries in excess of the budgeted salaries and claimed salaries in excess of actual cost ($185,232), less additional other revenues ($80,871).

[b] Represents the fringe benefits claimed for claimed salaries in excess of the budgeted salaries and claimed salaries in excess of actual cost ($22,134), less additional other revenues ($9,704).

[c] Represents $789 of inadequately supported expenses and an overclaim of $249.

[d] Represents inadequately supported expenses.

[e] Represents $9,254 of unauthorized interest expense and $2,031 of insurance expense that was not related to the program.

[f] Represents inadequately supported expenses.

[g] Represents interest and miscellaneous revenue not reported.