



STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

August 26, 2015

Honorable Lawrence K. Marks
Chief Administrative Judge
New York State Unified Court System
25 Beaver Street
New York, NY 10004

Re: Report 2012-0076

Dear Judge Marks:

Our office examined¹ payments the New York State Unified Court System (Courts) made to The Legal Aid Society of New York City (Legal Aid) during the period April 1, 2012 through March 31, 2013 under contract C250309. During the examination period, Courts paid Legal Aid \$39,450,972 for the Attorneys for Children Program (AFC Program). The objective of our examination was to determine if payments Courts made to Legal Aid were appropriate under the terms and conditions of the contract.

A. Results of Examination

We reviewed select payments totaling \$5,448,384 Courts made to Legal Aid for salaries, equipment, and real estate rentals and found Legal Aid spent these AFC Program funds appropriately. However, we found Courts overpaid Legal Aid \$412,184 for fringe benefit expenses that were not actual and allowable under the terms and conditions of the contract. Legal Aid did not appropriately reconcile fringe benefits at year end, moved funds in every non-personal services budget category without providing Courts with the required notification, and moved \$546,803 from non-personal services budget categories to personal services budget categories without obtaining the required prior written approval from Courts. In addition to the findings contained in this report, we also identified one matter of lesser significance related to our audit of administrative expenses. We conveyed this matter to Courts officials verbally during the closing conference and did not include it in this report.

Courts officials did not timely identify these inappropriate and/or unreconciled expenses or the unapproved movement of funds between budget categories. Courts has contracted with Legal Aid for many years, and should be careful not to develop a level of trust that could impair Courts

¹ We performed our examination in accordance with State Comptroller's authority set forth in Article V, Section 1 of the State Constitution, as well as Article II, Section 8, and Article VII, Section 111 of the State Finance Law.

officials' professional skepticism. Had Courts exercised the appropriate level of scrutiny over the AFC Program, which includes verifying that the amounts on Legal Aid's reconciliation reports were correct and complied with the terms and conditions of the contract, officials may have increased the likelihood of identifying the inappropriate expenses.

During the examination, we discussed with Courts and Legal Aid how to improve the contract language to allow for better transparency of contract funds. We worked with our Bureau of Contracts to provide suggestions for potential contract revisions for Courts' review. Subsequent to these discussions, we noted that for AFC Program contracts starting in January 1, 2015, Courts amended the contract language to allow for better transparency and accountability of contract funds.

We shared a draft report with Courts officials and considered their comments (Attachment A) in preparing this final report. The comments of the State Comptroller on Courts' response are included in Attachment B. In response to the report, Courts plans to improve AFC Program oversight to include more detailed budgets and reconciliation reports with increased scrutiny by Courts, enhanced guidelines to clarify allowable and unallowable expenses, and site visits to monitor and ensure compliance with contract terms and conditions.

B. Background and Methodology

The AFC Program provides legal representation and associated support services (e.g., social workers, investigators, etc.) to minors residing in ten New York counties. To carry out the AFC Program in the New York City region, for the period January 1, 2010 through December 31, 2014, Courts entered into a \$236,512,842 contract with Legal Aid. Legal Aid is comprised of a Civil Practice, a Criminal Practice, and a Juvenile Rights Practice (JRP). The JRP administers the AFC Program through the contract with Courts. During our examination period, Courts paid Legal Aid quarterly advances totaling \$39,450,972, or 100 percent of the amount budgeted for the annual period.

The terms and conditions of the contract specify Courts will only pay for actual and allowable expenditures for the AFC Program. In addition, the contract is structured as a "not-to exceed" contract. As such, Courts should only pay Legal Aid for the actual and allowable expenditures incurred up to the annual amount budgeted for each budget category. If Legal Aid moves funds among budget categories they must (i) obtain the appropriate approvals from Courts and/or (ii) provide Courts with timely notification of the change. In addition, the contract requires Legal Aid to submit reconciliation reports to Courts documenting the actual and allowable expenditures Legal Aid incurred, compared to the budgeted expenditures approved by Courts. If the advance

payments exceed Legal Aid's actual and allowable expenditures, Legal Aid must remit any overpayment back to Courts.

We examined contract payments totaling \$17,240,755 that Courts made to Legal Aid for the JRP from April 1, 2012 through March 31, 2013. This includes salary payments totaling \$3,263,134, fringe benefit payments totaling \$9,437,883, equipment payments totaling \$245,059, real estate payments totaling \$1,940,191 and administrative expense payments totaling \$2,354,488. To accomplish our examination objective, we analyzed the terms and conditions of the contract, interviewed Courts officials and Legal Aid staff, examined Legal Aid payment requests and reconciliation reports, and reviewed invoices, union agreements, and other pertinent documentation from Legal Aid and its vendors.

C. Details of Findings

Fringe Benefit Expenses

Legal Aid calculated an estimated fringe benefits rate to apply organization-wide. To calculate the quarterly fringe benefit amount to charge Courts, Legal Aid multiplied a varying organization-wide rate by the total amount paid for JRP employees' salaries. Using this estimated fringe benefits rate, Legal Aid charged Courts \$9,437,883 for fringe benefits during our examination period.

Contrary to the contract, Legal Aid did not reconcile the actual fringe benefit expenses it incurred against the amount it charged Courts. Rather, on a quarterly basis, Legal Aid provided Courts with reconciliation reports using budgeted fringe benefit expense amounts. Legal Aid officials claimed that determining the JRP's actual fringe benefit expenses would require a significant amount of work and they would have to hire additional staff in order to do so. However, the contract does not allow Legal Aid to bypass reconciling budgeted to actual expenses.

Legal Aid provided us with the actual healthcare costs for all JRP employees and pertinent rate information for fringe benefits. We analyzed this information and found Legal Aid actually incurred \$9,025,699 in fringe benefit expenses for JRP employees. As a result, Courts overpaid Legal Aid \$412,184 for fringe benefit expenses during the period April 1, 2012 through March 31, 2013. In response to our preliminary finding in this area, Courts officials committed to recovering \$412,184 from Legal Aid.

Budget Interchanges

The budget contains three major categories: personal services, non-personal services, and indirect expenses. These three categories are further expanded into specific budget categories such as salaries, fringe benefits, equipment, travel, etc. We found that Legal Aid moved funds in every non-personal services budget category without providing the required written notice to Courts. In addition, Legal Aid moved funds from non-personal services to personal services without obtaining prior written approval from Courts.

According to the final reconciliation report, Legal Aid expended the entire amount budgeted for the period, totaling \$39,450,972. To do so, Legal Aid interchanged a total of \$546,803 in budget category funding without obtaining the contractually-required approval from Courts.

In addition, we found Legal Aid's budget did not provide a sufficient level of detail to ensure transparency of how contract funds were spent. For example, while Legal Aid budgeted an amount for fringe benefits, they did not identify the types of fringe benefits, and corresponding amounts, included in the total. In addition, the salaries budget included an amount for supplemental payments to employees. However, this amount was unspecified, as Legal Aid did not distinguish the supplemental payments amount from the salaries amount. During our review of salaries and fringe benefit expenses Legal Aid claimed on the reconciliation reports, we determined the components of fringe benefit and salaries expenses only by examining documents beyond Legal Aid's budgets and reconciliation reports.

The budget Legal Aid developed and the terms and conditions established by the contract are intended to provide additional assurance that Legal Aid spent State funds appropriately. However, Courts officials did not ensure Legal Aid adhered to the terms and conditions of the contract when it came to interchanging budget category funds. Further, Legal Aid's budget lacked an appropriate level of detail needed to ensure transparency of contract expenses. Had Courts taken the appropriate steps to request documentation and verify the accuracy of the budget detail, it may have increased its likelihood of identifying unapproved budget interchanges. As a result, Courts was unable to sufficiently account for AFC Program funds.

Recommendations

- 1) *Recover \$412,184 overpaid to Legal Aid for fringe benefit expenses during the examination period.*
- 2) *Determine the amount of actual fringe benefit expenses Legal Aid incurred since the inception of the contract in 2010. Recover any additional overpayments.*

- 3) *Ensure Legal Aid performs sufficient reconciliations as required by the contract.*
- 4) *Modify the budget and reconciliation reports to ensure transparency and accountability for contract funds.*
- 5) *Ensure Legal Aid obtains prior approval from Courts before interchanging funds between budget categories.*
- 6) *Promote an environment that emphasizes the importance of internal controls and professional skepticism by monitoring to ensure Legal Aid is meeting the terms and conditions of the contract.*
- 7) *Consider reviewing terms and conditions of other contracts with Legal Aid to determine if payments for fringe benefit and administrative expenses were appropriate.*

We thank the management and staff of Courts for the courtesies and cooperation extended to our auditors. Since your response to our draft report is in agreement with these recommendations, there is no need for further response unless you feel otherwise. If you choose to provide a response, we would appreciate receiving it by September 25, 2015 indicating any actions planned to address the recommendations in this report.

Sincerely,

Bernard J. McHugh
Director of State Expenditures

Enc: Attachment A
Attachment B

cc: George Danyluk

**New York State Unified Court System
Response to the Office of the State Comptroller's
Draft Report for Audit of Payments Made to the Legal Aid Society of New York City**

The Office of Court Administration (OCA) is in agreement with the findings and recommendations, but request consideration of the following modifications to the report.

The report states, "Contrary to the contract, Legal Aid did not reconcile the actual fringe benefit expenses it incurred against the amount it charged Courts. Rather, on a quarterly basis, Legal Aid provided Courts with reconciliation reports using budgeted fringe benefit expense amounts." While OCA did reimburse Legal Aid for budgeted fringe benefit expenses for the first three quarters of the fiscal year, adjustments were made to the final quarter amount based on known changes in expenses for the full year. In fiscal year 2012-13, Legal Aid reduced the fourth quarter fringe rate to 35.9 percent. This resulted in an overall rate of 39.8 percent for the year, as compared to 40.07 percent from Legal Aid's audited financial statements. We request the report state that the fourth quarter fringe benefit amount was adjusted to reconcile actual expenses for the year.

Further, while not calculated on a cost per person basis, we believe the contract did permit the billing methodology used by Legal Aid to determine actual fringe benefit costs annually. We request that references to this methodology not being allowed by the contract be removed from the report. Legal Aid has agreed to use actual costs per employee to calculate fringe benefit expenses in the future.

* Comment 1

OCA has taken steps or plans to implement the audit recommendations, as follows:

1) Recover \$412,184 overpaid to Legal Aid for fringe benefit expenses during the examination period.

OCA will recover the overpayment for fringe benefit expenses.

2) Determine the amount of actual fringe benefit expenses Legal Aid incurred since the inception of the contract in 2010. Recover any additional overpayments.

The Unified Court System's Internal Audit unit will consider an audit of Legal Aid's fringe benefit expenses as part of its annual audit planning process.

3) Ensure Legal Aid performs sufficient reconciliations as required by the contract.

The Office of Court Administration's Division of Professional and Court Services has assigned the Legal Aid Society contract to the Senior Coordinator of Grants and Contracts, who will be actively involved in the budget review process and will personally review the reconciliation reports.

New contract language has been implemented which both clarifies what must be reported and requires Legal Aid (and any other contractor with high value fringe benefit costs) to routinely submit supporting documentation for all fringe benefit expenditures charged to the contract. The detailed requirements are included in Section II of Appendix D (Payments and Fiscal Reporting Requirements) of the new contracts executed with the Legal Aid Society (see Exhibit A). Fringe benefit documentation will be reviewed by an OCA Division of Financial Management budget analyst with fringe benefit expertise.

In addition, significant language changes were made to the contract to ensure that final reconciliations are true and correct (see Exhibit A, Section III).

4) Modify the budget and reconciliation reports to ensure transparency and accountability for contract funds.

UCS standard reconciliation report forms were modified to ensure that each fringe benefit sub-category is reconciled each quarter. In addition, the contract was modified to require that “if Indirect Costs are included in the budget, Contractor must submit an indirect cost allocation methodology with the budget for UCS approval.”

Under the terms of the contract, the Legal Aid Society is required to comply with “any UCS guidelines applicable to this Agreement, including but not limited to the UCS Financial Planning and Control Manual, and all rules and guidelines of the Chief Judge and/or the Chief Administrator.” The Office of Court Administration is revising its Financial Planning and Control Manual, chapter on Contracts with Not for Profit Organizations, to clarify allowable and non-allowable expenses under each budget category and to ensure the chapter conforms to changes in law and policy enacted since the prior revision. This revision will be implemented sometime during the current fiscal year.

5) Ensure Legal Aid obtains prior approval from Courts before interchanging funds between budget categories.

The requirements for prior approval of interchanges of funds between budget categories was clarified by OCA and acknowledged by Legal Aid in writing on September 18, 2013.

Further, significant changes have been made to the contract language to clarify budget amendment requirements and promote compliance (see Exhibit B).

6) Promote an environment that emphasizes the importance of internal controls and professional skepticism by monitoring to ensure Legal Aid is meeting the terms and conditions of the contract.

As noted above, the Office of Court Administration’s Division of Professional and Court Services and Division of Financial Management are both involved in the review of budgets and reconciliation reports. In addition, the Chief Administrative Judge has approved a plan to enhance the monitoring of all UCS service contracts. Under the plan, site visits will be conducted at the Legal Aid Society for each of the three UCS contracts.

Site visits will allow UCS to:

- a. Monitor and evaluate progress in completing contract deliverables.
- b. Ensure compliance with contract terms and OCA fiscal guidelines (cost allocation, fiscal documentation, personnel policies, etc.)
- c. Identify and anticipate any budgetary issues/requests and or anticipated changes in the scope of work.
- d. Provide programmatic and administrative technical assistance.
- e. Observe programmatic activities.
- f. Observe and collect information on innovative strategies that might be disseminated to improve practice in the field.

Significant fiscal related problems identified with any legal service contracts will be referred to Internal Audit for consideration of a future audit.

7) Consider reviewing terms and conditions of other contracts with Legal Aid to determine if payments for fringe benefit and administrative expenses were appropriate.

The improved procedures and contract modifications will be applicable to other contracts with Legal Aid. UCS Internal Audit will consider auditing other Legal Aid contracts as part of its annual audit plan.

Exhibit A

Appendix D: Payment Provisions and Fiscal Reporting Requirements

I. ADVANCE PAYMENT

- A. Subject to the availability of appropriated funds, UCS, in its sole discretion, may authorize advance payment to Contractor of up to twenty five percent (25%) of the maximum annual compensation amount for any Budget Period.
- B. If at the time an advance payment is processed, the maximum compensation amount for the Budget Period has not been established, the maximum compensation amount for the immediately preceding Budget Period (annualized, if the prior Budget Period was less than a full year) shall be used to calculate the amount of the advance.
- C. If an advance based on the maximum compensation amount for an immediately preceding Budget Period is made, and the maximum compensation amount for the then-current Budget Period, once established, is a higher amount, UCS may advance the difference between the amount advanced and 25% of the maximum compensation amount for the then-current Budget Period to Contractor. If an advance based on the maximum compensation amount for an immediately preceding Budget Period is made, and the maximum compensation amount for the then-current Budget Period, once established, is a lesser amount, a subsequent reimbursement payment to Contractor will be reduced to recoup the excess advance.

II. REIMBURSEMENT

- A. Contractor will be reimbursed only for allowable expenses incurred during the Budget Period.
- B. Within thirty (30) days of the expiration of each quarter of each Budget Period, Contractor shall submit to UCS a reconciliation report in a format prescribed by or acceptable to UCS. The reconciliation report must detail the following for each major budget category:
 - 1. Employee Salaries and Wages: Actual payments made during the quarter. The reconciliation report must articulate the actual total amount of payments made for salaries and wages for each position and/or category of positions between the start date and end date of the period as supported by payroll records.
 - 2. Fringe Benefits: Actual amounts obligated during the quarter. If the amount of fringe benefit expenses reported for the quarter is equal to or greater than \$1,000,000, Contractor must submit documentation supporting the expenses for each fringe benefit sub-category.
 - 3. Indirect Costs: The amount allocated for the quarter based on a UCS-approved cost allocation methodology.
 - 4. Equipment: The actual amounts obligated during the quarter and an updated Equipment Inventory Worksheet including a description, serial number (and/or internal inventory number), date purchased and purchase price of each item.
 - 5. Other Non-Personal Service Costs: The actual amounts obligated during quarter.

Appendix D: Payment Provisions and Fiscal Reporting Requirements

- C. Contractor shall supply supporting documentation for any and all expenses reported as part of the reconciliation review process upon request by UCS.
- D. Upon review and approval of Contractor's reconciliation reports and supporting documentation, UCS will authorize a reimbursement payment to Contractor for the applicable quarter.
- E. Reimbursement to Contractor shall be limited to the lesser of the following:
 - 1. The actual allowable expenses incurred and approved for payment during such quarterly period; or
 - 2. Twenty five percent (25%) of the approved maximum compensation allocation.
- F. UCS, in its sole discretion, may withhold a portion of any reimbursement payment to Contractor pending review and approval of supporting documentation. Upon review and approval of such documentation, UCS may authorize a supplemental reimbursement of expenses provided however, that no supplemental payment made will increase the reimbursement amount to an amount in excess of that specified in paragraph E(2) above.
- G. Adjustments to prior quarters can be made to rectify accounting errors or make expenditure adjustments. Adjustments to prior reconciliation reports that increase the allowable expenses for a previously reimbursed quarter may be reimbursed upon receipt, review and approval of the adjustment, provided however, that no adjustment made will increase the reimbursement amount to an amount in excess of that specified in paragraph E(2) above. Each reconciliation report submitted during the Budget Period shall supersede prior reconciliation report submissions.
- H. Under no circumstances will aggregate reimbursement for any quarter exceed 25% of the approved maximum compensation amount.

III. FINAL RECONCILIATION OF BUDGET PERIOD

- A. Within ninety (90) days following the expiration of each Budget Period, Contractor shall submit to UCS a final reconciliation report in a format prescribed by or acceptable to UCS detailing the allowable expenditures incurred by Contractor during such Budget Period.
- B. Contractor must liquidate all obligations incurred during the Budget Period no later than 90 days after the end of the period.
- C. If Contractor has incurred allowable expenditures in an amount that is less than the total amount paid to Contractor for such Budget Period (including, but not limited to, advance payments) Contractor shall remit any such overpayment to UCS within thirty (30) days of the submission of the final reconciliation report (or, in the event the reconciliation report is not timely submitted, within thirty (30) days of written request to Contractor by UCS).

Appendix D: Payment Provisions and Fiscal Reporting Requirements

- D. If Contractor has incurred allowable expenditures in an amount that is greater than the total amount paid to Contractor for such Budget Period (including, but not limited to, advance payments) UCS shall, upon review and approval of the final reconciliation report, authorize payment to Contractor of the approved amount; provided however, that nothing contained herein shall operate to increase the maximum compensation amount payable to Contractor during the term, or during any Budget Period of this Agreement, as set forth in the budget for such Budget Period.
- E. Expenditures reported on Contractor's final reconciliation report (as required pursuant to paragraph A of this section) must conform with Contractor's independent accountant audit, financial statements or other comparable independent accountant review (Accountant Report). In the event that Contractor's Accountant Report is received by Contractor after submission of the final reconciliation report and the Accountant Report indicates that the final reconciliation report contained any expenditure inaccuracy, Contractor must submit an amended final reconciliation report by the earlier of: (i) 60 days from Contractor's receipt of the Accountant Report; or (ii) one year after the end of the applicable Budget Period. Notwithstanding the foregoing deadline, in the event that Contractor learns at any time after submission of a final reconciliation report that the report contained any expenditure inaccuracy, Contractor shall submit an amended final reconciliation report correcting the inaccurac[y]ies. To the extent that any amended final reconciliation report results in a change in the incurred allowable expenditures, the terms of paragraphs C and D of this section will apply.

IV. ADDITIONAL REVENUE

- A. Contractor may supplement the funds provided by UCS pursuant to this Agreement by raising additional revenue from other public or private sources. Any such additional revenue anticipated by Contractor shall be reported to UCS, in an overall program revenue and expense budget, to be submitted in conjunction with Contractor's proposed budget for the Budget Period in which the revenue is to be applied.
- B. If additional revenue from other public or private sources is received and expended in furtherance of the program such revenue and related expenses shall be reported to UCS along with the final reconciliation report required in Section III above.

Exhibit B

UCS Standard Contract, Section III, Budget Modifications

(A). The following budget modifications require the prior written approval of UCS, which must be requested as specified in section III(D) below:

- (1) budget modifications that interchange amounts between major budget expense categories; and*
- (2) budget modifications that (i) change the total number of positions; (ii) change the number of positions in a given category of positions; or (iii) add or delete a position or category of positions.*

(B). Budget modifications that interchange amounts between major budget expense categories by an amount equal to or greater than ten percent of the total maximum compensation payable hereunder if the total maximum compensation is less than \$5,000,000, or five percent of the total maximum compensation payable hereunder if the total maximum compensation is \$5,000,000 or more, are also subject to the approval of OSC.

(C). Other than the restrictions specified in section III(A)(2), Contractor may interchange amounts between sub-categories within the major budget expense categories without the prior approval of UCS.

(D). Budget modifications that require prior written UCS approval must be requested as follows:

- (1) in advance whenever practicable;*
- (2) by submitting a budget modification request:*
 - (a) on a form prescribed by or approved by UCS;*
 - (b) accompanied by a narrative justification of each proposed interchange; and*
 - (c) under the signature of an official authorized to enter into contracts on behalf of the Contractor or that person's designee as previously confirmed in writing to UCS.*

(E). Budget modification requests that do not comply with the requirements of Section III(D) will be reviewed and considered at the sole discretion of UCS.

(F). Any expenses incurred pursuant to a budget modification that is subject to UCS approval and which is not submitted to UCS for prior approval will be reimbursed at the sole discretion of UCS and Contractor may be required to submit additional documentation in support of such expenses.

(G). Upon approval, a modified budget will replace the previous Appendix B for the applicable Budget Period.

State Comptroller Comments on Auditee Response

1. We disagree the contract permitted the reconciliation methodology Legal Aid used to determine fringe benefit expenses. According to Section V., Part B of the contract, Legal Aid is required to reconcile to actual allowable costs or 20 percent of the approved annual budget on a quarterly basis. Instead, Legal Aid either reconciled budgeted costs or only a portion of the actual allowable costs. This methodology is inconsistent with the contract requirements.